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PRIVATE CORPORATIONS

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§ 1. **Outline.** This subject will be treated in the following order: Chapter I. The general nature of a corporation: 1. Definition and history. 2. The corporation as a person. 3. The corporation as a collection of individuals. 4. The corporation as a franchise. 5. Corporations and other institutions. 6. Tests of corporate existence. 7. Classes of corporations. Chapter II. Creation of corporations: 1. The state's functions. 2. The promoter's functions. 3. The corporate charter. 4. The association agreement. 5. Organization. Chapter III. The body corporate: 1. Members and organs of action. 2. Internal relations. 3. Corporate funds. 4. Corporate name. 5. Corporate life. 6. Corporate death—dissolution. Chapter IV. Corporate powers and liabilities: 1. Powers in general. 2. Classes of cor-

porate powers. 3. Particular powers. 4. Ultra vires. 5. Torts and crimes. Chapter V. The corporation and the state: 1. The state and its own corporations. 2. The state and national corporations. 3. The state and foreign corporations. 4. The national government and state corporations. Chapter VI. Special relations: 1. The corporation and its promoters. 2. The corporation and its officers. 3. The corporation and its shareholders. 4. Corporate creditors.

CHAPTER I.

GENERAL NATURE OF A CORPORATION.

SECTION 1. DEFINITION AND HISTORY.

§ 2. **Definitions.** In a recent opinion Judge Baldwin says: "A private corporation may be defined as an association of persons to whom the sovereign has offered a franchise to become an artificial, juridical person, with a name of its own, under which they can act and contract, and sue and be sued, and who have accepted the offer and effected an organization in substantial conformity with its terms" (1). There are three leading ideas in the definition of a corporation, each of them being important in certain circumstances. These ideas are: *A person*—"a corporation is an artificial being invisible, intangible, and existing only in contemplation of law;" *a collection of persons*—a corporation aggregate is a "collection of many individuals united into one body, under a special denomination, having perpetual succession in an artificial form, and vested by the policy of the law with the capacity of acting in several respects as an individual;" *a franchise*—"a corporation is a franchise possessed by one or more individuals, who subsist as a

(1) Baldwin C. J. in Mackay v. New York & N. H. R. Co., 72 Atl. 583, 586 (Conn).

body politic, under a special denomination, and are vested by the policy of the law with the capacity of perpetual succession and of acting in several respects, however numerous the association may be, as a single individual" (2).

§ 3. **Theories of the corporate personality.** There are three of these, viz: (a) The *fiction* theory, i. e., that the corporate personality is not *real* but *artificial* only: "The abstract idea of a corporation, the legal entity, the impalpable and intangible creation of human thought is itself a fiction, and has been appropriately described as a figure of speech" (3). This is the currently accepted American view, and is specially insisted upon by Mr. Morawetz and Mr. Taylor.

(b) The *organic* theory: This is the German doctrine. This view is that the corporation has a personality as *real* as that of the state; that in law a *person* is anything that is a distinct subject of rights and liabilities. "Juristic persons are no more fictitious than, say, the conception of ownership is fictitious. In the eye of the law they are in the fullest sense *persons*, that is, subjects of legal rights and duties, and to that extent '*real*,' as far as modern law is concerned" (4).

(c) The *representative* theory: This may be summarized as follows: The rights held by a corporation are not the rights of any physical person, but those of the corporation as a distinct person in the law; the act of the

(2) 2 Kent, Commentaries, 257.

(3) Judge Finch, in People v. North River Sugar Refining Co., 121 N. Y. 582.

(4) Sohm, Institutes of Roman Law (2d ed.), 204, note.

majority is accepted as the act of all and those who act bind those who are silent; in other words, the majority vote of the quorum is the *representative* of all, and this is true whether the vote has been by A to X, inclusive, or by B to Y, inclusive, in a corporation composed of A to Z. Any group that is the majority of the quorum is the representative of the corporation and is no *unreal* thing; the will of this representative body duly expressed is the corporate act or will, whether it be of knowledge, ignorance, error, good or bad faith, or wrong doing or commendable action. This makes up the *unity* of the *corporation,* which it is convenient, if not entirely necessary, to treat as a person in the law (5).

§ 4. **Theory of the collective body.** Mr. Morawetz says: "The word corporation is but a collective name for the corporators or members who compose an incorporated association" (6). Mr. Taylor says: "A corporation considered as a legal institution has two meanings: (1) The sum or mass of the legal relations subsisting in respect to the legal enterprise among the various parties—the state, the shareholders, the officers, and the creditors—resulting from the operation of the rules of law embraced in the corporate constitution; (2) the shareholders, vested with the corporate powers, since it is through their acts or the acts of their predecessors that incorporation is caused" (7). Mr. Trapnell analyzes the subject and concludes: "A corporation is an association of individuals,

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(5) Professor Ernst Freund, The Legal Nature of a Corporation.

(6) Private Corporations (2d ed.), § 1.

(7) Corporations (3d ed.), §§ 36, 37, 49, 50, 51.

formed under the sanction of the state, for the accomplishment of a distinct and definite purpose"—these being the three essential elements. The association originates in an agreement between individuals, which becomes effective only by the express sanction of the state; this association is peculiar in that its rights and liabilities persist unchanged without regard to changes in membership; membership is acquired by original subscription, or agreement, or subsequent ownership of stock, and is terminated by assignment of stock; the association is dissolved, voluntarily with the consent of the state, or, on complaint of shareholders or creditors, for various improper acts. The states's sanction is essential, and is expressed in a general or special legislative act, which operates as a grant of corporate power to the associates, constituting a contract with them, and a law prescribing the form and mode of exercising these powers, and the results thereof. These powers are given only for the purpose of accomplishing the expressed objects, through the forms prescribed, by means of the funds authorized (8).

§ 5. **Theory of the franchise.** Blackstone says: "Franchises are a royal privilege or branch of the king's prerogative subsisting in the hands of the subject;" and "it is likewise a franchise for a number of persons to be incorporated and subsist as a body politic, and each individual member of such corporation is also said to have a franchise or freedom." Mr. Justice Bradley, after quoting this, says: "Generalized and divested of the

(8) The Logical Conception of a Corporation, by Benjamin Trapnell.

special form which it assumes under a monarchical government based on feudal traditions, a franchise is a right, privilege, or power of public concern, which ought not be exercised by private individuals at their mere will or pleasure, but should be reserved for public control and administration, either by the government directly, or by public agents, acting under such conditions and regulations as the government may impose in the public interest and for the public security. No persons can make themselves a body corporate and politic without legislative authority. Corporate capacity is a franchise" (9). The state in its political capacity is the holder of all franchises, in trust for the public welfare; and when it makes a grant of any such franchises they do not lose their public character, but are yet to be exercised in advancing the public welfare; this is an essential, though implied, condition of the grant; if not performed the state can resume the grant as for a condition broken. The right to be and act as a corporation, mainly based upon historical reasons, is considered, and wisely so, as a right or privilege of public concern. This is true even though the business to be done is of a private nature, such as refining sugar or oil. The business is neither more nor less public than if done by individuals in their private capacity, but the privilege consists in bringing into existence and using in the business the valuable, efficient, impersonal, and in many ways less responsible agency, known as the corporation; this is the matter of public concern, which is the essence of the corporate franchise.

(9) California v. Central Pacific Ry. Co., 127 U. S. 1, 40.

The corporate franchises are frequently said to be *primary* and *secondary*. The primary franchise is the privilege to be, to exist and act as a corporation; the secondary franchises are such other franchises or special privileges, such as the right to take property by eminent domain, as may be conferred upon the corporation, just as they might be conferred upon natural persons.

§ 6. **History of these ideas. The corporate personality.** Hearn and Coulanges trace the idea of corporate personality to the ancient family group, which was a permanent body, enduring forever, with rights and duties distinct from those of its individual members, who included both the living and dead, and whose representative and managing director was the house father. In the earliest stages of human development, the existence of tribes, village communities, families, clans, and nations was recognized in such a way as to imply they were collective entities with corporate rights and duties. In the ancient Babylonian and Egyptian law, the Temple was personified (10). Long before Justinian, the rule of the Digest, "All the members are considered as a single unit or being," had thoroughly penetrated the fabric of Roman law. Churches and boroughs and guilds, even in Anglo-Saxon times, were personified as owners of lands, franchises, and privileges, in a way different from the ownership of the individual persons who were members of the same. Bracton (about 1260), likened a corporation to a flock of sheep, which remains the same flock although

(10) Johns, Babylonian Laws, 208; Simcox, Primitive Civilizations, I, 173, 376.

particular sheep successively depart. By 1311 a borough is called a "*corps,*" a body. In 1349 the courts said, "the corporation is invisible, incorporeal, and cannot be arrested or assaulted;" and in 1461 said, "a corporation aggregate of several is invisible, immortal, and rests only in intendment and consideration of law"—words frequently repeated ever since. By the reign of Edward IV (1461-83) the term "*corporacion*" had come into general use. In the register of names of persons recognized by the private law of Rome, the names of corporations were entered in precisely the same way as those of natural persons. So too, Lord Coke, followed by Lord Hale, and by Blackstone, says: "Persons are of two sorts—natural, created by God, and persons incorporate, created by the policy of man."

As the family grew into the clan, the clan into the tribe, and the tribe into the city, nation, or state, the corporate idea of the family seems to have been applied to the state, particularly in its external and public relations, and every sovereign and independent government or society claimed for itself the attributes of perpetuity and personality. Such an idea early took shape in the Roman law, and, by the end of the Samnite wars (B. C. 282), Rome had become a government of a city over cities throughout Italy. For a long time the property of the city was treated as a public matter, standing outside the domain of private law and commerce; but, during the Empire, it was brought within the range of private law, and the cities began to be treated as persons capable of having *private* as well as public rights and duties. Societies created by the con-

ventions of individuals, but without proprietary capacity, had long existed; these were quick to solicit and secure from the state, as *lawful societies* (collegia licita), proprietary capacity after the example of the cities; and in this way "Roman law contrived to accomplish a veritable masterpiece of juristic ingenuity in discovering the notion of a collective person, distinguishing from its members the collective whole as the ideal unity of the members bound together by the corporate constitution, in raising the whole to the rank of a person (a juristic person), and in securing it a place in private law as an independent subject of proprietary capacity, standing on the same footing as other private persons" (11). Yet it took nearly a thousand years after the time of Justinian for these same ideas to be appropriated or worked out again by the English law.

§ 7. **Same: The corporate franchise.** The legal ideas involved here are traceable to the doctrines of both the Roman and the feudal law. From the Roman law comes the doctrine that a corporate franchise is a privilege of a public nature conferred by the state; from the feudal law comes the view that this privilege is not merely a *personal* privilege or liberty, such as the right to move about, but a privilege in the nature of a *property* right. We have just seen how the idea of a corporate personality was traced to the public law of Rome—to sustain a juristic personality was originally exclusively the privilege of public corporations and institutions. In the Roman law

(11) Sohm's Institutes of Roman Law, Ledlie's Translation (2d ed.) Ch. II.

"a corporation was an organized body of persons governing themselves." The Romans were jealous of combinations of individuals for any such purpose. The law recognized no general freedom of association; a lawful self-governing society could not be the creation of individuals; many laws were passed from the time of the Twelve Tables (450 B. C.) down to the Empire against illicit companies. Only such societies were lawful as owed their existence to a special public law. Being constituted by public law, they became thereby institutions of the state, partook of its nature, and acquired thereby a corporate personality and proprietary capacity. Julius Caesar and Augustus both dissolved many corporations that had become nurseries of faction and disorder (12). Based therefore upon political instinct as well as upon legal theories, it became a maxim of the Roman law that to usurp the franchise of being a corporation without due authority was unlawful.

Similar ideas early obtained in the English law. In Saxon and early Norman times the nobles exercised the power of conferring corporate privileges within their demesnes. Yet, in the time of Henry II (1154-1189), 18 guilds were fined for being set up without lawful authority. In the time of Bracton (c. 1260) the right to grant franchises and liberties was considered the exclusive prerogative of the king. In 1349 it was held that the right to sue and be sued as a person could be conferred on a guild only by the king, and the absolute necessity of the king's assent to the institution of any corporation was

(12) 2 Kent Comm. 268.

held in 1376 to have been previously settled as clear law, or, as elsewhere stated, by the fourteenth century "the foundation is being laid for a rule which will require a royal license when a new corporation is to be formed" (13). The king, because of political expediency and for financial reasons, had begun to interfere with the creation of voluntary associations and guilds, for they had given trouble in France and might do so in England. "Besides, men will pay for leave to form clubs," and the medieval guild was not content with the purely private status of a club, but aspired "to exercise some jurisdiction and coercive power over its members and perhaps over outsiders." In the time of Henry I (1100-1135), the weavers of London, and in the time of Henry II (1154-1189), the weavers of York, Lincoln, Huntingdon, and Oxford; the fullers of Winchester; the men of Marlborough; and the bakers of London, all pay for the privilege of having their guild.

By the time of Edward I (1272-1307), English boroughs had acquired five characteristics—"the right of perpetual succession, the power to sue and be sued as a whole and by the corporate name, the power to hold lands, the right to use a common seal, and the power of making by-laws" (14); but the theory of their *personality* was not yet entirely worked out. And, when they first appear as ideal persons, they still appear not in the character of mere private persons, but rather as governmental officers. "Their lands, their goods are few, what they

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(13) Pollock and Maitland, Hist. Eng. Law (2d ed.), 669.
(14) Maitland, Const. Hist., 54.

own is jurisdiction, governmental powers, and fiscal immunities;" in other words they were "the owners of *franchises.*" This is so also with the merchants' guilds; they seemed to be voluntary associations of traders on one hand, and organs of municipal government on the other; they had no property engaged in trade, but their "property consisted not of lands and goods but of franchises, jurisdictional powers, and fiscal immunities." All such franchises or liberties (as they were called in the Great Charter, c. 29) "covered feudal rights and incidents of too intangible a nature to be appropriately described as '*holdings,*'" and were treated by the medieval law as *private property* (15). And so, in this capacity of private ownership of franchises, "we may well suppose that the juristic person made its appearance at a comparatively early time in the guild hall of the brethren." By the time of Edward IV (1461-83), it was considered that in the grant of all franchises there is "a tacit condition annexed to them that an abuse forfeits them." In the argument of the great quo warranto case against the city of London in 1692, it was said: "A corporation is an artificial body, the ligaments of which body are the *franchises* which bind and unite all its members together; and the whole essence and frame of the corporation consist therein," or, as expressed by Comyn (c. 1745), followed by Blackstone (1765), "a corporation is a franchise created by the king." This theory was made the

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(15) McKechnie, Magna Carta, 445. Holdsworth, Hist. of Eng. Law, Vol. 1, 63.

basis of Mr. Justice Washington's opinion in the Dartmouth College case in 1819 (16).

§ 8. **History of corporations: In Europe.** As already seen, both public and private or trading corporations existed under the Roman law; under the convenient cloak of the latter, patricians were enabled to engage in remunerative trade and business, from which they were otherwise excluded by public sentiment. After the fall of Rome, most of the commercial corporations disappeared, and only those connected with the church survived. A little later, guilds of workmen and traders began to be formed, which gradually took on the corporate form, growing in strength and power until "in merchant guild, and church guild, and craft guild lay the life of Englishmen who were doing more than knight or baron" to preserve or bring safely across ages of tyranny or win back the right of self government, free speech, and equal justice at the hands of one's equals. Lord Coke claimed to have seen "a charter made by Henry I (1100-1135) by which he granted them gildam mercatorum, and a confirmation by Henry II (1154-1189) by which charters they were incorporated." The Brotherhood of St. Thomas a Becket was authorized in Burgundy before 1250, and a century later transferred to England, confirmed by Edward III and Henry VII who changed its name to the Merchant Adventurers of London, under whose monopoly, in the time of Elizabeth, it had gathered five-sixths of the foreign trade of England into the port of London and into the hands of two hundred share-

(16) 4 Wheat. 518, 657.

holders. Other guilds and brotherhoods were formed early also; the "Weavers Company" goes back to Henry II, if not to Henry I; the Goldsmiths date from 1327; Mercers, 1373; Haberdashers, 1407; Fishmongers, 1433; Vintners, 1437; Merchant Tailors, 1466.

The Italian states were engaged in extensive commerce in the time of Charlemagne, and about 1150 organized a Chamber of Loans which grew into the Bank of Venice by 1171, and became the model of later institutions and of the custom of paying by cheques. The Company of St. George—the Bank of Genoa—dating about 1402, consolidated the public loan into one capital stock to be managed by eight directors annually elected by the stockholders and creditors. The discovery of America made the world larger and soon led to the formation of great companies for exploring and exploiting it. The Russian company dates from 1566; the Eastland, 1579; the Turkey, 1581; the famous East India Company dates from 1600; the Plymouth Company, known as the Merchant Adventurers, that colonized New England, was chartered in 1606, with a capital stock of £7000, and the Hudson Bay Company, still operating in the Canadian northwest, in 1670. When the East India Company was formed, each member traded on his individual stock, taking such shares in each voyage as he chose, according to the rule laid down by the company, but in 1612 the stock was converted into a joint stock—the aggregate subscriptions of the members—to be managed by the governor and directors. The Bank of England was incorporated in 1694.

§ 9. **Same: In America.** During colonial days it is

said there were but six business corporations of American origin: the New York Company "for settling a fishery in these parts," chartered in 1675 by Governor Andros, under his patent of 1664, with a capital stock divided into shares of £10 each; the Free Society of Traders in Pennsylvania chartered in 1682 by William Penn, with a capital stock of £5400, subscribers for fifty pounds to have one vote, one hundred pounds two votes, three hundred pounds or over three votes; the New London Society for Trade and Commerce, dating from 1732; the Union Wharf Company in New Haven, 1760; the Philadelphia Contributership for Insuring Houses from Loss by Fire, 1768; and the Proprietors of the Boston Pier, 1772. Before the formation of the United States Constitution there seems to have been only 21 business corporations formed in the United States. The Constitution put commerce and vested rights on a solid footing, and, before 1800, 200 more corporate charters had been granted. Before 1830, the improvident increase of corporations was looked upon as an evil. In 1822 President Monroe vetoed extensive projects of national internal improvements; the states took up the matter and disastrously failed; then the era of private corporations began about 1840 under liberal general incorporation laws. Prior to 1870 there were few corporate combinations. Railroad consolidation began about 1869, and before 1870 scarcely any system was over 1000 miles; by 1890, 5000 mile systems existed; by 1900, 10,000 mile systems, and now Mr. Harriman dies in control of 70,000 miles of railroad—one-third of all in the country. Before 1870 industrial combina-

tions were small, two trusts having been formed with capital of $13,000,000; but by 1904 it was stated 445 trusts existed, formed out of 8664 original companies, with a capitalization of over $20,000,000,000—the United States Steel Corporation alone having $1,100,000,000 in stock and nearly $400,000,000 in bonds.

SECTION 2. THE CORPORATION AS A PERSON.

§ 10. **When a corporation is considered as a person. Rights and duties.** For most purposes it is so considered, and especially: (1) As having rights of property and reputation protected at common law, and under constitutional provisions, very much as natural persons. (2) As having duties, arising both from its charter provisions and fixed upon it by the common law. Illustrations: Where the state grants to a university corporation all the property that hereafter escheats to the state, it cannot repeal the law so as to divest the university of its title to all property that has escheated to the state before the repealing law takes effect. To do so would violate the provision of the Bill of Rights, taken from Magna Charta, that "no freeman shall be disseized of his freehold, or his liberty, but by the law of the land" (17). D falsely, orally, and publicly accused C, a coal company, during the coal famine of 1902-3, of charging exhorbitant prices for coal and refusing to sell at all to those who were sick and suffering. No special damage was alleged. Such a charge violates the company's right to its business reputation, and is actionable slander without showing special

(17) Trustees of University v. Foy, 1 Murphy (N. C.) 58.

damage (18). Where the state constitution provides that individuals shall be taxed on their property, after deducting the amount of unpaid mortgages upon it, but also provides for taxing the property of railroad companies without such reduction, such provision violates the Fourteenth Amendment to the Federal Constitution that "no state shall deny to any person within its jurisdiction the equal protection of the laws" (19). Where a railroad is authorized to build a bridge across a navigable river, the state may compel it by mandamus to construct it so as not to obstruct navigation and to remove such obstructions as have been erected. Where a canal company is bound by its charter to construct its canal deep enough to accommodate rafts of a specified size, and negligently fails to keep its canals in proper condition therefor, the company is liable in damages to one whose raft of the proper size is grounded and later destroyed by a storm—the charter having placed this duty on the company for the benefit of persons wishing to use the canal, upon payment of the proper toll (20).

§ 11. **Same: Statutory construction.** (3) Statutes, conferring rights or placing obligations upon persons, generally include corporations, though not specially named. Corporations, however, are not *citizens* entitled to all the privileges of citizens of the several states under the United States Constitution; but they are *citizens* within the clause giving the United States jurisdiction in

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(18) Gross Coal Co. v. Rose, 126 Wis. 24.

(19) The Railroad Tax Cases, 13 Fed. R. 722.

(20) Riddle v. Proprietors, 7 Mass. 169.

suits between citizens of different states. For example, where a judge was required to order an election to determine whether a court house should be removed, "upon applications of persons paying one-third of the taxes on real property in the county;" one-third of the taxes were $3333; of this individual owners paid $1300 and corporate owners the balance; it was held the judge was justified in ordering the election, as corporations were persons within the meaning of the law (21). So statutes allowing persons to appeal, or take notes, or their property to be attached or taxed, or forbidding persons from banking or taking usury, apply to corporations. So a corporation is a living person within the meaning of the statute allowing the party to testify when the adverse party is a living person. On the other hand, where the statute defines homicide as the killing of one human being by another, and manslaughter in the second degree as a killing due to the culpable negligence of any person, etc., a corporation cannot be indicted for manslaughter, since 'another' means another human being (22). And where the statute says "any number of persons may incorporate," persons here does not include corporations, for it is contrary to the policy of the law to allow one corporation to be formed from others. So too the constitutional provision that "no person shall be compelled in any criminal case to be a witness against himself," does not protect a corporation from the production of its books before the grand jury on the charge against a corporation for violating the

(21) Crafford v. Supervisors, 87 Va. 110.

(22) People v. Rochester Ry. Co., 195 N. Y. 102.

anti-trust act (23). Neither is a corporation of one state entitled to all the privileges and immunities of citizens of the several states, and so another state may exclude it from doing business altogether within that state (unless the business is interstate commerce), or make various discriminations against it, such as charging a higher license fee than is charged to its own corporations, or allowing a preference to domestic corporations. But if C company is incorporated in state A, with X, Y, and Z, as members, all living in state B, C can sue X, or Y, or Z, or be sued by them in the Federal courts, which have jurisdiction of suits when the parties are citizens of different states; for the corporation is presumed to be a citizen of the state where it is incorporated, without regard to the citizenship of its members.

§ 12. **Same: Ownership of property.** (4) In the ownership of its property, a corporation is considered as a *person*, it owns *its property*, and its members do not own its property. If the property is to be conveyed or recovered, it must be done in the corporate name, and not in that of the members. Suits must be brought by and against it in the corporate name. For example: Where the statute provided that "no vessel should be registered which shall not wholly belong to her Majesty's subjects," a vessel owned by an English corporation is entitled to registry, although a large part or all of its members were Frenchmen (24). So where A conveyed land to B and covenanted that he would not convey any of his remain-

(23) Hale v. Henkel, 201 U. S. 43.

(24) Queen v. Arnaud, 25 L. J. R. 50.

ing land to any person of color, he did not violate this covenant by conveying his land to a corporation composed entirely of colored persons (25). P, having acquired all the stock of C company, brought a suit to replevy from D property formerly belonging to C. Held, P could not maintain such a suit, for the property belonged to a corporation and not to the sole shareholder (26).

SECTION 3. THE CORPORATION AS A COLLECTION OF INDIVIDUALS.

§ 13. **When a corporation is considered as a collection of persons:** (1) In the management, the majority controls. (2) When justice requires, the corporate personality will be ignored, and the rights and duties of the members composing it be considered. This appears usually: (a) In matters relating to changing the constitution. (b) In determining the rights of members among themselves in equity. (c) When corporate sins result from the concerted but apparently individual acts of members. (d) When the corporate organization is used as a cloak to aid in commission of fraud. As an old case says, "where an act is to be done by a corporation all of the members ought to be assembled together to consent, but this cannot be separately and apart by them at several times." Again where C sued D on a note given for a subscription to stock in C company, which was organized to engage in life insurance, and later the company's charter was amended, authorizing it to engage in fire in-

(25) People's Pleasure Park Co. v. Rohleder, 61 S. E. 794 (Va.).
(26) Button v. Hoffman, 61 Wis. 20.

surance also, to which D did not consent, D was held not liable (27), for this is an organic change that requires unanimous consent, unless otherwise provided in forming the corporation. Where the corporation, through its directors, after a shareholder makes a proper demand, refuses to resist the payment of a tax levied against it under an invalid law, a shareholder may sue in equity to enjoin payment, for such payment is a breach of trust toward the individual shareholder. So too, where A and B, doing business as a partnership, which is in debt, transfer all their partnership property to a corporation, the shares of which they cause to be issued to their wives without payment, and without making any provision to pay the debt, the court will ignore the corporate existence so far as may be necessary to have the property applied to pay the debts of the partnership. And again, where all the members of several corporations together agree to transfer their shares to trustees, who are to issue trust certificates in return to the shareholders, for the purpose of vesting the management of all the corporations in the same hands in order to prevent competition among the corporations, the court will treat the acts of the shareholders as equivalent to formal acts of the corporations themselves, and will dissolve the combining corporations for becoming members of the trust. So too, when one corporation is organized by the officers and stockholders of another corporation, making their interests identical, the court may treat them as identical, if justice so requires; and generally the notion of the *legal entity* will

(27) Ashton v. Burbank, 2 Dillon (U. S.) 435.

not be permitted "to defeat public convenience, justify wrong, protect fraud, or defend crime" (28).

SECTION 4. THE CORPORATION AS A FRANCHISE.

§ 14. When a corporation is considered as a franchise. It is considered as a primary franchise mainly in its relation to the state, and particularly: (1) In the methods by which the state retains control over it—by the writs of scire facias or quo warranto. (2) In its incapacity to alienate its franchise, without the consent of the state. These two are based on the doctrine that the franchise to be a corporation is granted upon the implied condition that the grantees will faithfully carry out the purposes for which it was formed. (3) In the power of the state to tax corporations, the franchise may be considered property. (4) In the state's incapacity to change the charter without the consent of the members. (5) In the limit on the power of the majority to change the constitution of the corporation without the consent of all the members. These last three are based on the doctrine that a franchise, once granted and accepted, is a vested estate or interest in the members, of which they cannot be deprived without their consent.

From the earliest times, as Lord Holt said, "a corporation may be forfeited, if the trust be broken, and the end for which it is instituted be perverted;" the state does this by a direct proceeding in court to call the corporation to account for "misuser, abuser or non-user." It was very early ruled that "royal franchises never pass

(28) United States v. Milwaukee Refrig. Co., 142 Fed. R. 247; In re Rieger, etc., 157 Fed. R. 609.

by assignment, without special words in the king's grant," and that A could not inherit a right to hold a market from his father, to whom King John had granted the right, unless the grant itself so provided. Such a rule still obtains as to primary franchises, and often as to others also. Where C company made an assignment of all its property and effects of every kind to A for the benefit of its creditors, A petitioned to be allowed to sell the "franchise to be a corporation," as part of the property assigned, but the court ruled that this primary franchise really belonged to the members and could not be assigned unless expressly provided in the grant (29). So the franchise—the right to be a corporation—may be taxed by the state, as where the constitution provided for taxing all property at its actual value, including "moneys, credits, stocks, franchises, and all other things capable of private ownership"—the right to be a corporate bank is a franchise, and is capable of private ownership, and may be taxed to the corporation itself, upon a valuation equal to the difference between the assessed value of its tangible property and the market value of its outstanding shares (30). While the franchise is intangible, the ownership of it is a vested interest in the corporation and the shareholders, analogous to the ownership of interests in land under the same grant—neither the grantor, nor the grantees can change it without the consent of all.

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(29) Fietsam v. Hay, 122 Ill. 293.

(30) Bank of California v. San Francisco, 142 Cal. 276.

Section 5. Corporations and Other Institutions.

§ 15. **Corporation and partnership.** These differ: (1) In origin: the idea of corporations is traceable to the public law of Rome, as above pointed out, while the partnership notion is traceable to the customs of merchants in England and on the Continent and back to Roman traders. (2) In creation: corporations can be created only by express authority of the state; partnerships, by mere contract of parties. (3) In franchise: a corporation has at least one franchise, a partnership none. (4) In management: a corporation is managed only through its duly appointed officers and agents; in partnerships, each partner or member can act for the partnership. (5) In powers: the corporation can lawfully exercise no powers except those expressly conferred or necessarily implied from those granted; these cannot be enlarged except by the state's consent; the members of a partnership may do anything lawful that they agree to. (6) In duration: the corporation is perpetual unless expressly limited; the death, resignation, or insolvency of members does not dissolve; but either of these dissolves a partnership. (7) In ownership of property: the title to the corporate property is in the corporation; that of the partnership in the members of the partnership—they are all considered part owners. (8) In litigation: a corporation sues or is sued in its corporate name; the partnership, in the names of its members. (9) In transfer of interest: the transfer of his interest by a member has no effect on corporate existence; but a transfer of interest dissolves a partnership. (10) In liability of members: in absence of

statute, a member of a corporation is not liable beyond the amount to be paid for his shares; but in partnership, there is an individual liability to the extent of its debts. (11) In dissolution: a corporation can be rightly dissolved only by or with the consent of the state; partners may dissolve a partnership at any time. (12) In theory of existence: a corporation is a legal entity; a partnership is not so considered in English law, except in a few cases, though business men treat it so.

From the foregoing it will be seen that there are many advantages in the corporate organization: continuous succession, indefinite duration, limited liability, unlimited division of transferable shares of capital that can be used as collateral security, with a uniform and uninterrupted management, if found efficient, which readily secures large capital from numerous contributors. On the other hand, however, there may be less opportunity to scrutinize carefully the management, than in the case of a partnership; the chances of double taxation are greater; the corporation can be excluded from doing business where partners may claim the right to engage in such business as *citizens*; and the corporate powers are limited by the charter, which can be changed only by consent of the state.

§ 16. **Corporations and joint stock companies.** A joint stock company is sometimes said to be a "partnership, with many of the powers of a corporation." It is an evolution of partnership law; some of the incidents of partnership, such as non-transferability of shares, or authority of a partner to bind all the others, is excluded by the contract or statute under which it is formed. While

it can be formed, as between the members themselves or the members and those who deal with it with full knowledge, merely by contract, such formation without express authority does not exclude the partnership liability to those who have no knowledge of the facts. All presumptions are in favor of the partnership liability, and it can be excluded only by express statutory provision or actual knowledge of the party. They are usually authorized by statute, with transferable shares, and managed by a board of directors.

The presumptions of corporation law are exactly the reverse—there is no individual liability here unless expressly created by statute. For example: A, the owner of a patent, executed an instrument of trust declaring himself trustee for various persons to be known as the McKay Machine Association, which should exist for thirty years, with 50,000 shares to be distributed among the members in proportion to their interest, evidenced by certificates transferable on the books of the trustee; such transfer or the death of the owner was not to dissolve the association; no member was to have any authority to contract for the association, but all the business was to be carried on by an executive committee, chosen by the shareholders; profits were to be divided by this committee from time to time, and paid to shareholders in proportion to their interests. There was no statute expressly providing for the formation of such an association. A, as trustee, was taxed upon all the tangible real and personal property of the association, and the state sought to tax the association on the aggregate value of the

shares, less the assessed value of the real and personal property, as corporations were taxed upon their franchises. Held, it could not be so taxed, as it had no franchise, and was only a partnership formed under the common law (31). So too, where a statute authorized the formation of a "partnership association," with transferable shares, managed by a board of managers, with power to take and hold property, sue and be sued in its association name, and use a seal, and such an association was formed in Pennsylvania and did business in Massachusetts—it could not be sued in its association name in Massachusetts, as a corporation could. It must be sued as a partnership, in the names of its members (32).

§ 17. **Corporation and fraternity or stock exchange.** An unincorporated society resembles a partnership more nearly than a corporation; it is not a legal entity, and hence those who claim to be agents of such an institution bind only themselves and those who authorize them to act. The members are not authorized to act for one another as in partnerships.

§ 18. **Corporations and cost-book mining companies.** By custom of miners, there has grown up an unincorporated association that is quite like a joint stock company, in which the shares are transferable without affecting the continued existence of the association; only those especially appointed have authority to bind others. Otherwise partnership rules apply.

§ 19. **Syndicates.** These are in fact temporary part-

(31) Gleason v. McKay, 134 Mass. 419.

(32) Edwards v. Warren Linoline, etc. Works, 168 Mass. 564.

nerships organized for a particular transaction, such as to purchase or subscribe for a large amount of stock in a corporation to be formed, so as to insure the completion of the proposed scheme. As soon as the special transaction is completed, the syndicate is terminated. They are substantially partnerships (33).

§ 20. **Corporations and state institutions.** There are in many states, state universities, asylums, penitentiaries, etc., managed by boards created by law, and appointed by the governor or elected by electors. These are frequently called corporations of a public kind; while in other states they are not so considered, although they have some corporate powers. They are, in such states, called state institutions, and are subject to modification at the state's will without violation of the constitutional prohibition against impairing the obligation of contracts (34).

Section 6. Tests of Corporate Existence.

§ 21. **Tests of corporate existence.** Many times it is difficult to tell whether a particular institution is a corporation or not. The following tests have been suggested: (1) The *merger of the individuals* composing the corporate body into one distinct artificial individual existence. (2) The *legislative intent*—if this can be clearly ascertained it will be controlling in the creating state but not necessarily elsewhere. (3) The *powers conferred*—as to have perpetual succession under a special name, and in an artificial form; to take and grant property;

(33) 5 National Corp. Rep. 455; 8 Q. J. Econ. 98.
(34) Thomas v. Board of Trustees, 198 U. S. 207.

contract, sue, and be sued in this name; and to receive other grants and privileges. (4) In foreign jurisdictions, the powers conferred, rather than the legislative declaration will control. For example: The constitution of state A provided that the assent of two-thirds of the members of each branch of the legislature should be requisite to every bill creating any body politic or corporate. A statute provided that any number of persons may associate to establish a banking business, upon filing a certificate giving name, place, amount of stock, number of shares, names of shareholders, and duration of association. Such persons were authorized to do a banking business, exercise such powers as were incidental thereto, choose a president and other officers; president and cashier were to sign contracts, notes, etc. Suits were to be brought by or against the association in the name of the president, but not to abate by his death; conveyances were to be made to or by the president; shares were to be personal property, transferable on the books of the association, the vendee acquiring all the rights and liabilities of the vendor, and no shareholder was to be personally liable for the debts of the association. The act did not receive a two-thirds vote. A bank was organized, and P, as president sued D to recover on demands due the bank. While it was held in the lower court that the powers conferred by the foregoing statute were sufficient to make the banking institutions corporations, and hence invalid under the constitution, this view was reversed in the higher court, and these institutions were held not to be corporations within the meaning of the constitutional

provision, since there was not a complete merger of the members into the artificial being, inasmuch as it could not sue or be sued or hold lands in its association name (35). Again the statute provided for taxing "all moneyed or stock corporations" on their capital stock. The National Express Company was organized as a joint stock company in 1853, under a law of 1849, and materially differed from a corporation; afterward by various enactments such powers were conferred upon such express companies as to make them appear to be corporations, yet in all these acts they were still designated joint stock companies, instead of corporations. It was held that the legislature did not intend to make them into corporations and so they could not be taxed as such. So too, while an insurance company organized in England, as a joint stock company, under a law expressly providing that it was not a corporation, could be treated as a corporation in Massachusetts for purposes of taxation, or a New York express company, organized as a joint stock company under the laws above referred to, could be sued in New Jersey as a corporation, yet such an association would not be considered as a citizen of the state in which it was organized, so as to give the Federal courts jurisdiction, because of diversity of citizenship, when it was sued by a citizen of another state (36).

SECTION 7. CLASSES OF CORPORATIONS.

§ 22. **Classes of corporations.** The basis of classification may be: (1) As to number of members: Aggre-

(35) Warner v. Beers, 23 Wend. (N. Y.) 103.
(36) Great Southern Hotel Co. v. Jones, 177 U. S. 449.

gate and sole. An aggregate corporation is one in which there is capacity to have more than one member at a time. In a sole corporation, there is capacity to have only one member at a time. (2) As to purpose: They are ecclesiastical (or religious), and lay; which latter are eleemosynary and civil. An ecclesiastical corporation was one composed of spiritual persons clothed with a spiritual jurisdiction and subject to control by the church authorities. They do not exist in this country, for the state cannot confer ecclesiastical jurisdiction, as it has none. Religious corporations are, with us, corporations of a civil kind, formed to manage the temporalities of a church. All other than ecclesiastical were lay corporations, organized for various secular purposes; they were divided into eleemosynary, formed to distribute the alms or bounty of their founder; and civil, which were for any other lay purpose. (3) As to completeness of corporate existence: Corporations are said to be pure and perfect, those that have all the powers of self management incident to corporations at common law; and quasi or imperfect, having only part of the powers incident to corporations at common law. A municipal corporation is an illustration of the first, and a county or township, of the latter. (4) As to their relation to the state: Corporations are (a) public, formed for a governmental purpose; as a municipal corporation; (b) quasi-public, one that is really a private corporation, but charged with the performance of some specially public function, like a railroad company; (c) private, those formed for the private benefit of the members themselves, as a manufacturing

company. (5) As to method of acquiring membership: Corporations are non-stock, in which membership is acquired by election or complying with the corporate constitution or by-laws; and stock-corporations, wherein membership is acquired by the complete ownership of shares. (6) As to validity of corporate existence: Corporations are: (a) de jure, one whose right to exercise corporate powers is invulnerable, if assailed by the state in quo warranto proceedings; (b) de facto, one whose existence is ordinarily invulnerable against any one but the state, in a direct quo warranto proceeding; (c) by estoppel, one which has no legal existence except as against someone who is estopped from raising the question.

CHAPTER II.

CREATION OF CORPORATIONS.

§ 23. **In general.** A corporation is created through the joint act of the state and individuals, usually designated *incorporators* or *promoters;* these apply to the state for the privilege of becoming incorporated themselves, or of creating a corporation out of other individuals, or a group or association of other individuals or corporations. After permission is given, these promoters organize or provide for the organization of the corporation; their functions then cease; the members or subscribers contribute the capital, elect directors and officers, and take general control of corporate affairs; the directors and officers then start and keep in operation the ordinary powers of the corporation (1).

SECTION 1. THE STATE'S FUNCTIONS.

§ 24. **State's power to create.** The power to create a corporation is an incident of sovereignty, and so does not have to be conferred by constitutional provision (2). So, too, the sovereign's consent is essential—no other power can rightfully create a corporation. None but the sovereign can create, and none but the sovereign that creates can take away the franchise to be a corporation.

(1) 1 Cook, Stock and Stockholders (3d ed.), § 2.

(2) McCulloch v. Maryland, 4 Wheat. 316.

§ 25. **Evidences of the sovereign's consent.** These are mainly four: (1) By king's charter; (2) by common law; (3) by prescription; and (4) by legislative act. Lord Coke long ago said the essentials of incorporation are: 1. *Persons* to be incorporated. 2. A *name* by which they are incorporated. 3. Of a certain *place*. 4. *By sufficient words,* and although the words "incorporate," "found," "erect" or "create" are generally used they are not essential; any words indicating an intention to create are sufficient.

§ 26. **By king's charter.** In England, by the common law, this was the usual way; the power still exists in the king, and is sometimes exercised, particularly in creating corporations for establishing colonies. In England the power, however, is now usually exercised through acts of Parliament to which the king's consent is essential. The king, however, cannot create a corporation with power of imprisonment, give it a monopoly, or jurisdiction contrary to the common law. Private business corporations are now organized under the general law called the Companies' Act of 1862, and amendments since; public service companies require a special act of Parliament, and are incorporated only after investigation and report upon their necessity. Several corporations still exist in this country under charters granted by the king before the American Revolution.

§ 27. **Creation by common law.** The state and the nation, in their organized capacity, are corporations; so, also, the king, the bishop, or parson (in the English church), or executive officers generally, in their official

capacity, are considered corporations sole. They are not *incorporated,* in the ordinary sense, but the common law holds these to be corporations, so far as is necessary to enable their functions to be performed without break, in case of death or removal; the office or state endures though the officers die—or, as the common law maxim was, "the king never dies." For example, a school superintendent's bond made to the "governor of the state," can be enforced by any governor, when default occurs, though not the governor when the bond was made, and though there is no statute authorizing such a bond. It is good at common law, and the "governor" is a corporation sole, so far as necessary to enforce it (3).

§ 28. **Corporate existence by prescription.** At common law when a corporation could show that it had exercised corporate powers for a long period of time, its right to be a corporation could not be questioned by any one but the state or king; the common law indulged the presumption that the proper charter had once been granted, but, through lapse or accidents of time, had been lost; its right to exist was then said to be by *prescription.* With us, in the case of public corporations, the same presumptions are made; though it has been said that they will not be made in case of private corporations. There seems to be no very good reason for such a statement, since, in the absence of any evidence to the contrary, the presumption of right doing ought to be indulged, and the statutes of limitations relating to quo warranto, should be given effect not only against the state, but its citizens as well.

(3) Governor v. Allen, 8 Humph. (Tenn.) 176.

§ 29. **Creation by legislative act.** In England, the king, as supreme executive, was the holder of all the franchises of the commonwealth, and hence his consent was essential to the creation of any corporation; with us the legislative bodies are the custodians of the state's franchises, and hence no corporation can be created without legislative consent. Such power inheres in our general legislative bodies, and is exclusive and plenary as to time, place, method, and purpose, unless limited by constitutions, or by the nature of legislative power, or of a franchise. For example, where a bank was created by the legislature without express constitutional provision, it was held the bank was validly created, since the state legislatures can do all things not prohibited by their constitutions (4). So too, Congress can create a corporation to carry out any of the express powers conferred by the Constitution, for such a power is incident to the legislative authority conferred upon Congress within its province (5).

§ 30. **Forms in which the legislative authority is exercised.** These are, when constitutions do not prevent: (1) By *special act*; (2) by *general act*; (3) by *implication;* (4) by *consolidation.* The last two are really only special instances of one or other of the first two.

§ 31. **By special act.** Until about 1840, this was the usual method in the United States, and to a great extent in England; the special act was usually enacted at the suggestion or through the influence (good or bad) of those who wished to become incorporated, and would

(4) Bell v. Bk. of Tenn., Peck (Tenn.) 269.

(5) Luxton v. North River Bridge Co., 153 U. S. 525.

give such powers and qualities as the whim or caprice of the promoters or the legislature dictated; corporations for like purposes had entirely unlike organizations and powers; bribery and corruption were not infrequently resorted to for the purpose of procuring or perpetuating charters; "the time of the legislature was unnecessarily consumed; the integrity of the members of the legislature was unduly exposed; or, through the ignorance or carelessness of the legislature, and the astuteness and diligence of designing and overreaching men, there were constantly coming to light clauses in these acts of the legislature, giving powers and granting privileges which were unjust, inequitable, and which never would have been done with the knowledge of the legislature." In this way Aaron Burr secured a charter for a company to supply the city of New York with water, with authority to use its surplus capital "in any way not inconsistent with the laws and constitutions of the United States and New York," under which the Manhattan Bank has been carrying on its banking business since 1799 (6).

§ 32. **By general act.** It is possible that this method was in use at Rome; the first general law in use in England was in the time of Coke, allowing the erection of hospitals; it was not extended to other corporations. After the political views of the American and French revolutions, that all men were entitled to equal rights, became the motive power of political life, clamor was made for equal privileges in the formation of corporations; to meet this doctrine and to prevent fraud and legislative jobbery

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(6) Century Magazine, May, 1899; Parton's Life of Burr, 238.

incident to the grant of franchises by special act, general laws were enacted for the creation of corporations, by complying with easy and simple requirements. As early as 1784, New York, followed by Pennsylvania in 1791, made such a law as to churches; North Carolina in 1795 provided for canal companies in this way; Massachusetts made general regulations for manufacturing corporations in 1809; New York provided for the incorporation of such corporations in 1811; and by 1840 nearly every state had such provision for one, or all, class or classes of corporations. But general acts were not sufficient to overcome the difficulty, for the legislature could and often did create corporations under special acts, though there was a general law under which similar corporations could be formed. It was found necessary to limit the legislature in some way. New York, in her constitution of 1821, provided that the "assent of two-thirds of the members elected to each branch of the legislature shall be requisite to every bill creating, continuing, altering, or renewing any body politic or corporate." In 1838, Florida, in her constitution, forbade the creation of churches by special act, and required the legislature to pass a general law for their incorporation. In 1845, Louisiana did the same as to all except municipal corporations. In 1846, New York did likewise, and such provisions are now found in most of the state constitutions.

§ 33. **By implication.** Where rights and powers are granted to an association of persons, and there is no mode by which such rights and powers can be enjoyed or exercised, without acting as a corporation, such an associa-

tion is, by *implication,* held to be a corporation to the extent necessary to make such rights and powers available. For example, where the statute provided that the board of directors of a state university shall have the custody of the property of the university, and all lands shall be taken, held, transferred, and managed by said board, and it shall make by-laws, elect members of the faculty, and fix their salaries, such a board is a corporation so far as is necessary to enable it to hold lands and sue and be sued, though the legislature had not declared it to be a corporation (7), yet not to such an extent as to prevent the legislature from modifying it, if it saw fit to do so.

§ 34. **By consolidation.** The legislature, by general law (or special act, where constitutions do not forbid), may provide for the formation of one corporation out of two or more existing corporations. This is designated *consolidation,* or amalgamation. This matter is further considered below.

§ 35. **Limits upon legislative authority.** These are such as arise: (1) From the nature of legislative authority. Since legislatures with us are held to have delegated authority only, it is usually said they cannot re-delegate their discretionary powers to others, and hence cannot delegate to any other body the general power to create corporations; this limitation does not prevent the passing of a general law providing for the creation of corporations by complying with the terms indicated, and directing an executive officer to certify to the fact of compliance. A real exception, however, appears to exist, in

(7) Dunn v. University of Oregon, 9 Ore. 357.

the power of Congress to delegate to the territorial legislatures power to create corporations. (2) From the nature of a franchise. By the common law an individual cannot have even a benefit thrust upon him without his consent, so the state cannot incorporate into a private corporation any person who does not consent to be a member. It follows from this that there must be an acceptance of the act of incorporation by the persons to be incorporated before the act becomes operative. Perhaps the rule is otherwise as to public corporations. (3) From constitutional provisions. These are found in the national or state constitutions, and are considered below.

Illustrations of the first two above are: Where the statute provides that, when the persons interested shall desire to form a corporation, they shall petition the court in writing, setting forth the objects and privileges they desire to exercise, with the name to be used, and the court shall make an order to have the petition entered upon the record, and when this is done the petitioners shall be a corporation with certain powers specified in the act, there is no improper delegation of legislative power (8). Where a majority of landowners petitioned to be incorporated with power to lay out and improve a street, and levy the cost upon the adjoining lands, it was held that a party who had not consented to become a member could not be made such, and have his land sold for refusing to pay his assessment. The legislature has no "power over a person to make him a member of a corporation, and subject

(8) State v. Dawson, 16 Ind. 40.

him to taxation, nolens volens, for the promotion of a private enterprise" (9).

§ 36. **Powers of Congress.** The national Constitution neither expressly authorizes nor forbids the formation of corporations; but ever since Secretary Hamilton's report upon the national bank, and the decision of McCulloch v. Maryland (10), it is clear that Congress has the incidental power to create any corporation that it deems necessary or convenient in carrying out any of its great substantive powers; it can create a bank, railroad, bridge, turnpike, telegraph, and such like corporations, to be located and operated in any of the states either with or without the state's consent, so far as necessary to provide for interstate commerce (11); it has also exercised the power to create a corporation for building a canal across the Isthmus of Panama; and now owns and operates a railroad across the Isthmus. Such corporations are not entirely foreign in any state, may exercise the power of eminent domain within the state if so authorized for a public purpose, are exempt from state taxation or control if such would impair their efficiency as an instrument of the national government, and have the right to sue and be sued in the Federal courts unless otherwise provided. It is doubtful if the national government can create a corporation to engage generally in manufacturing, mining, or agriculture, within the states, without their consent (12). Within the territories, or in the Dis-

(9) Ellis v. Marshall, 2 Mass. 269.

(10) 4 Wheat. 316.

(11) Luxton v. North River Bridge Co., 153 U. S. 525.

(12) Rep. Am. Bar Assn., 1904, p. 732 ff.; 3 Mich. L. R. 264 (Feb., 1905).

trict of Columbia, Congress has unlimited power to create corporations.

§ 37. **National restrictions on state legislatures.** There are no express limitations, but there is the implied limitation that no state can create corporations for such purposes and confer upon them such powers as would prevent the exercise of such exclusive or concurrent power as Congress has over the same subject. As where a state incorporated a telegraph company with the exclusive right to construct and operate its telegraph lines along a railroad, which, by Federal legislation, was a post road, along which any telegraph company organized under the laws of any state, might, upon obtaining the consent of the railroad company, construct and operate its lines; the exclusive grant of the state must yield to the right of a telegraph company complying with the Federal laws (13).

§ 38. **Powers of territorial legislatures.** The power to create corporations inheres in such bodies, subject to control by Congress; Congress has provided that they can be formed only under general laws, which are subject to repeal or amendment by the territorial legislature or Congress.

§ 39. **State constitutional limitations.** The most usual constitutional limitation is that the legislature shall pass "no special act creating corporations," or "conferring corporate powers," but they "shall provide by general law for the creation of corporations, and all such laws shall be subject to amendment or repeal." By the weight of authority, creating corporations, and conferring cor-

(13) Pensacola Tel. Co. v. Western Union Tel. Co., 96 U. S. 1.

porate powers, are equivalent, though some cases hold that after the corporation is once created under general law, other or special powers can be conferred upon it by special act. Such provisions do not prevent the classification of corporations upon some reasonable basis, and the enactment of provisions for the creation of these different classes with different powers and functions for each class. A law which relates to a class of persons or things is *general,* while a law relating to particular persons or things of a class is *special.* Other constitutional provisions sometimes require that no law shall embrace more than one subject, and this shall be distinctly set forth in the title; others require laws for the creation of corporations to receive a two-thirds or three-fourths vote of the members of the legislature.

Where the legislature passed a general law for the incorporation of water works companies, and the next day passed a special act giving E and his associates, as soon as they should incorporate under the general law, the right to supply water to San Francisco, charge certain rates therefor, and have certain rights and be subject to certain burdens, different from those granted or imposed under the general law, such second act violated the constitutional provision that corporations should not be created by special act (13a). So, by special act, to authorize a particular city to take in additional territory, "confers corporate powers," contrary to the constitutional inhibition. But on the other hand, a special act authorizing an existing railroad company to purchase the railroad of another ex-

(13a) San Francisco v. Spring Valley W. W. Co., 48 Cal. 493.

isting company, and, after doing so, to change its own name, does not create a corporation contrary to a provision that corporations shall not be created by special act (14).

SECTION 2. THE PROMOTER'S FUNCTIONS.

§ 40. **Definition and classes.** A promoter is a person, by whatever name, who sets the machinery in motion, procures the subscriptions, directs the end, looks after the organization, prepares the prospectus, and negotiates the agreements, necessary in the formation and creation of a corporation. For convenience we may call promoters (1) statutory, which may be divided into (a) commissioners, under special acts, and (b) incorporators, under general laws; or, (2) self-constituted.

§ 41. **Commissioners.** Under special acts it was usual to designate a part or all of the applicants as *commissioners* to open books, receive subscriptions to stock, distribute the stock, call a meeting for organization, and superintend such meeting; their functions then ceased; such functions were of a public, discretionary character; the commissioners stood toward the corporation and subscribers as trustees. They, however, could subscribe themselves, and exercise their discretion in making allotment of shares if there was an over-subscription (15).

§ 42. **Incorporators.** Under general laws, a certain number of persons are required to sign and file articles of incorporation; they are called *incorporators* or *cor-*

(14) Wallace v. Loomis, 97 U. S. 146.
(15) Walker v. Devereaux, 4 Paige Ch. (N. Y.) 229.

porators, and are usually directed or permitted to call for subscriptions to the stock, call an organization meeting of subscribers, act as inspectors of the first election, certify who are elected, and appoint a time and place of the first directors' meeting; their functions are about the same as the commissioners under special acts; they may or may not, as they choose (at least under some statutes), subscribe for stock. Their functions cease as soon as the organization is complete (16).

§ 43. **Self-constituted promoters.** The law allows others, besides commissioners or incorporators, to take many of the steps preliminary to incorporation; anyone who actively undertakes any necessary step is a promoter; he introduces the enterprise to desirable persons, informs them of its nature, solicits their aid, indicates possible profits and the capital needed, and discharges various other details. In recent years his functions have become important, especially in organizing one corporation out of former existing corporations. The steps he usually takes are: (1) Securing options on the stock or property of the companies to be combined; (2) financing the concern by securing the money necessary to complete the transaction, and furnish working capital; (3) organizing the new company. As soon as options are obtained, a proposition is made to some financial house to *underwrite* the stock (i. e., agree to take it, if the public does not) of the new corporation, to the extent sufficient to furnish all the cash necessary for the transaction, for a commission usually to be paid in stock of the new company. As

(16) Nickum v. Burkhardt, 30 Ore. 464.

soon as such agreement is made, the promoter secures the fewest possible persons necessary to incorporate with the least possible amount of stock, but with authority to increase the stock to the amount required. As soon as this small amount of stock is subscribed, the corporation is organized by the selection of the requisite officers; these then increase the stock to the amount necessary, authorize the issue of all of it to the promoter, who, in consideration therefor, agrees to have conveyances of all the property or stock of the corporations, upon which he holds options, made to the new corporation; by simultaneous transactions, these conveyances, duly executed, are delivered to the corporation, the promoter delivers the stock or cash to the old companies in payment, and delivers, to the financial house, the stock which it was to receive as commissions; if any stock is left the promoter appropriates it as his fee for engineering the deal (17). The legal relations of promoters to the corporation, to shareholders, and among themselves, are discussed elsewhere.

SECTION 3. THE CORPORATE CHARTER.

§ 44. **General nature.** The legal conception of a corporation consists in the offer and acceptance of a charter —a written or printed instrument—wherein are set forth the terms and conditions upon which the state, by legislative act, will permit an individual or association of individuals to exercise the franchise or franchises granted therein. It is both a *contract*—resulting from the offer

(17) St. Louis. F. Scott, etc. R. R. Co. v. Tiernan, 37 Kans. 606; Old Dominion Copper Co. v. Bigelow, 188 Mass. 315; Same v. Lewisohn, 210 U. S. 206.

and acceptance, and also a *law* enacted by the legislature, conferring the powers indicated; it is a contract the obligation of which cannot be impaired by either party to it without the consent of the other party (18); it is also a law, such that every person is supposed to know its contents, under the maxim that "ignorance of the law excuses no one" (19). If general, the courts take judicial notice of it; if special, it usually must be pleaded and proved. In its first instance, however, the charter or articles of association is a license of authority for the persons named to convert themselves or other persons, or an association of others, into a corporation by organization, in compliance with the conditions indicated. Although the statute provides that, upon the filing of articles of incorporation, the subscribers thereto "shall thereafter be deemed a body corporate," such does not in fact make a corporation, and it is usually held that no company really exists until the requisite stock has been subscribed, and an organization is completed by naming the directors.

§ 45. **Offer and acceptance.** The offer may be made either by the state to persons (as is the case in general laws), or by persons to the state (as is usual in special acts), and the acceptance be by the other party. Acceptance is essential, but need not be formal; it can be implied from acts, such as organizing and acting under it; to be valid, as against the state which makes the offer (unless the law otherwise expressly provides), the acceptance must be within the state making it, by all to whom the

(18) Trustees of Dartmouth College v. Woodward, 4 Wheat. 518.

(19) Hoyt v. Thompson, 19 N. Y. 207; Central Transportation Co. v. Pullman Car Co., 139 U. S. 24.

offer was made. Renewals, extensions, and amendments must be accepted in the same way. For example, a special act was passed in January, 1849, authorizing persons named to form a railroad company; November 1, 1851, the new constitution of the state provided that "corporations shall not be created by special act;" June 2, 1852, the grantees met, accepted the special act, and organized. Held, the acceptance was too late, and the corporation was invalid (20). But when it appeared that the same parties had applied for the charter, in the same words in which the state passed the special act in January, 1849, there was an offer to, and acceptance by, the state, and the corporation was valid (21). Where parties, authorized by a law of Maine to form a corporation, met in New York, accepted the charter, and elected directors, who authorized the president, chosen at the same time and place, to execute a mortgage, such mortgage was void, since the corporation had not been lawfully formed. The reason was that natural persons in themselves have no power to form a corporation; the charter or law alone confers such a faculty; this law is inoperative outside of the state enacting it; and the corporate faculty cannot, therefore, accompany the natural persons outside of the state, and be exercised there (22). This severely technical view is now modified by the rule that the corporation, incorporators, and officers who participated in such acts outside of the state are estopped to deny their validity.

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(20) State v. Dawson, 16 Ind. 40.
(21) State v. Dawson, 22 Ind. 272.
(22) Miller v. Ewer, 27 Me. 509.

§ 46. **What makes up the charter.** Under a charter from the king, or by a special act of the legislature, the instrument or act itself makes up the charter, and usually sets forth in detail the name, powers, method of acquiring membership, management, etc. Under general laws *articles of incorporation* or association are required to be entered into and filed with some public officer; the charter then consists of (1) the provisions of the *general law,* and (2) the *articles of incorporation,* consistent with the general law. Where the general corporation statute was silent as to the power of a railroad corporation formed under it to lease its road, a power to lease, placed in the articles of incorporation, would not give such power, since it was inconsistent with the general law, on the ground that an enumeration of powers excludes those not enumerated (23).

§ 47. **Provisions of general law.** These enumerate the purpose or purposes for which corporations can be formed; contain provisions or restrictions as to the number of incorporators, name, duration, amount of stock or debt, location of offices, number and qualification of directors and officers, liability of members, method of voting, notice of meetings, quorum, etc. Also they contain certain provisions as to what the articles of incorporation shall contain, and how they shall be executed.

§ 48. **Articles of incorporation.** The general law usually requires that those who wish to incorporate (not less than a certain number of natural persons competent to contract), shall enter into written articles of incorpora-

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(23) Oregon R. R. Co. v. Oregonian Ry. Co., 130 U. S. 1.

tion, sign, and acknowledge the same (as they would a deed), and file the same with some public officer, who is to record the same (if found to comply with the law), and furnish a certified copy thereof under the seal of the state to the applicants; this copy so authenticated usually is made *prima facie* evidence of the existence of the corporation. The general law usually requires these articles to set forth the name of the corporation, its purpose, location, duration, amount of stock, number of shares, officers, directors, and, in some cases, other matters. They must conform to the general laws (inconsistent provisions are surplusage and void), and usually cannot, even though claimed, secure any powers except such as are expressly allowed by the general law; in New Jersey and Delaware, however, any powers may be *created* by the incorporators, if claimed in their articles of association, and not expressly forbidden by the general law. Under the first general incorporation law in England for the formation of hospitals, the corporation was created by a *deed of settlement,* setting forth the organization in the deed endowing the charity. This is not usual in this country. Under the English Companies Acts, a memorandum of association, similar to our articles of incorporation, is to be entered into and filed with a registrar, who issues a certificate stating the corporation has been formed. In England, after the *memorandum* is executed, the parties may adopt *articles of association,* which correspond to the *by-laws* adopted by the members after the articles of incorporation are executed in the United States.

§ 49. **Where to incorporate.** In the absence of express statutory requirements, incorporators do not need to reside in the state in which they seek to be incorporated. So also, under the rules of comity that obtain throughout the United States, a corporation formed under the laws of one state is permitted to do business in another state. In some of the states the incorporation laws are much more liberal than in others, and confer much more extensive powers. In fact, many states have so liberalized their corporation laws as to be fairly open to the charge of bidding for the fees arising from incorporation. Business men generally prefer to incorporate where they can secure the broadest powers, be hampered least, and be required to give as little information to the public as possible. It has therefore become customary to inquire "where is the best place to incorporate for certain purposes?" The so-called liberal or desirable states, for one reason or another, are genrally stated to be: Arizona, Connecticut, Delaware, District of Columbia, Maine, Massachusetts, Nevada, New Jersey, New York, Porto Rico, South Dakota, and West Virginia.

The points to which attention and comparison are usually directed are: Whether part or all of the incorporators or directors must be residents of the incorporating state; whether there is a maximum or minimum limit to the capital stock, and a limit to corporate indebtedness; what part of the stock is required to be subscribed, or paid in, before doing business; whether stock can be paid for in property or services, and, if so, whether, in the absence of actual fraud, the judgment of the directors

as to the value of the property taken in payment of stock is conclusive, or only prima facie sufficient, or whether the matter is for the court or jury to determine; whether the shares may be issued with preferences or not; whether the shareholders' or directors' meetings must be held within the incorporating state; whether the shareholders are authorized to vote by proxy, or to cumulate their votes; whether there is any statutory liability upon shareholders or directors for debts of the corporation, or for failure to make certain reports; whether directors are liable for paying dividends out of the capital, or whether shareholders are liable for receiving such dividends, not knowing they have been so paid out of capital; whether a transfer of unpaid shares releases the transferror; whether the records, minute-, account-, and stock-books must be kept within the state, and be open to inspection of shareholders or public officers; whether annual reports as to names of officers, directors, shareholders, and details as to paid up capital, debts, and operations are required; whether the corporate property, surplus, and franchise are subject to tax, and if so how; whether shares are taxed to the shareholders also, and whether they are subject to an inheritance tax; what are the powers as to consolidation, leasing and selling property, and holding its own shares or shares in other corporations; can material amendments be made without unanimous consent; can directors prefer themselves as creditors; are directors liable only for gross negligence, or must they exercise the reasonable care of competent business men in the management and control of the corporate business; what

are the organization and filing fees; are the provisions of the law under which it is proposed to incorporate plain and clear, and have the courts passed upon their meaning (24).

It will be readily seen that the foregoing questions and others like them require the careful attention, comparison and advice of a competent attorney before any definite conclusion can be reached. Sometimes it is considered desirable to incorporate in a foreign rather than the domestic state, or the reverse, so that suits may or may not be brought or removed to the Federal courts.

SECTION 4. THE ASSOCIATION AGREEMENT.

§ 50. **Its necessity and nature.** Since a corporation aggregate is composed of more than one person, the organization of which is not thrust upon any one, some association of a contractual character necessarily precedes, accompanies, or results from, the formation of a corporation; it need not be, though it usually is, a formal or written transaction, and sometimes it is very complex and intricate. Its general nature, however, is an agreement by each associate with his fellows to organize for the purpose contemplated, and to contribute his proportion of the funds agreed, the consideration being the mutual promises of the parties.

§ 51. **Forms of association contracts.** These are various, but may be classed as: (1) An exclusively statutory contract; or, (2) a common law agreement. These latter

(24) See Machen, Modern Law of Corporations, 2 Vols. 1908; Corporation Manual with Forms 1907-8; Frost, Incorporation (3d ed.) 1908; Clephane, Business Corporations.

are: (a) An agreement to subscribe for stock in the corporation to be formed; (b) an agreement subscribing for stock in a corporation to be formed, or after it is formed; (c) subscriptions to promoters, agents, or trustees; (d) underwriting contracts; (e) application, allotment and notice; (f) conditional subscriptions.

§ 52. **Statutory contract.** In some states where the statutes provide that articles of incorporation shall be filed, in which shall be stated the names of the incorporators, and the number of shares which each agrees to take, all who wish to become members must subscribe for the stock in the articles of incorporation, and no other method of subscribing will be valid. This view, however, seems to be confined to a few cases in New York and Missouri, under special statutes; the general rule in other states is otherwise. For example, where the statute provided that any number of persons not less than five might incorporate by making and subscribing articles of association, "by signing his name and place of residence, and the number of shares he agrees to take," and A, on a preliminary subscription paper, "agreed to take the number of shares written opposite our names"—$5500—but did not sign the articles of incorporation, and died before the articles of incorporation were executed and filed, such subscription could not be enforced against the estate of A, the court saying "the statute neither contemplates nor alludes to any preliminary paper of subscription," and one can become a member in no other mode than the one pointed out in the statute (25).

(25) Sedalia, W. & S. Ry. v. Wilkerson, 83 Mo. 235. Compare: Shelby Co. Ry. v. Crow, 119 S. W. 435 (Mo. App.).

§ 53. **An agreement to subscribe for stock** in a corporation to be formed in the future, contemplates a subscription upon the books of the company after they are properly opened; the person does not by such an agreement, become a member, nor can the corporation enforce the subscription. Where T signed a paper agreeing "to subscribe the sum set against our names, when the books may be opened for subscription"—$3000—and T refused to subscribe when the books were opened and he was notified, T could not be held as a member and be liable for the whole amount of the stock, but only for such damages as the corporation could show it had suffered by T failing to subscribe as agreed (26). Some authors claim there is no difference between an agreement *to subscribe*, and an *agreement subscribing*; i. e., a present subscription, particularly when the corporation is not yet formed (27). The courts, however, take a different view (28).

§ 54. **Agreements subscribing for stock** in a corporation to be formed have occasioned much conflict as to their legal effect, and at least four theories exist: (1) That it is a mere offer, withdrawable at any time before the corporation is organized and accepts the offer; death or insanity revokes it, and any one may withdraw upon giving notice to the person who took the subscription (29). (2) That it is an offer, until acted upon in accordance

(26) Thrasher v. Pike Co. R. Co., 25 Ill. 393.

(27) Prof. Collins, Rules given in 1 Cook, Corporations (5th ed.), § 75.

(28) Yonkers Gazette Co. v. Taylor, 30 N. Y. App. Div. 334.

(29) Bryant's Pond Co. v. Felt, 87 Me. 234.

with the provisions, and then becomes a binding contract. (3) That it is a binding contract from the time it is made (30). (4) That it is an offer to the proposed corporation before its incorporation and acceptance, but a binding agreement between the subscribers from the time it is made (31). The first view probably has the weight of authority. If the subscription is made to the stock of the corporation already formed, which accepts the subscription, the contract is binding from the time of acceptance. Illustrations of the foregoing views are as follows: F signed for 20 shares on a paper reading "we hereby agree to pay for the number of shares set opposite our names, etc." This was signed by several others, all before the company was incorporated; and, before incorporation, F notified the person who had taken his subscription that he wished to withdraw, and asked that his name be taken off the list. Held, he could so withdraw (note 29, above). So too, where H, along with others, signed "we hereby subscribe for and agree to purchase the shares set opposite our names," under seal, he could withdraw before incorporation by notifying the person who took his subscription. So, where a party signed a similar paper, but not the articles of incorporation, and waited until after incorporation to withdraw, it was too late. On the other hand, where a party signed a preliminary paper of the same kind before incorporation, and died before incorporation, his estate was held liable on the subscription, on the theory that such an agreement

(30) Tonica & Petersburg R. R. v. McNeely, 21 Ill. 71.

(31) Minneapolis Threshing Mach. Co. v. Davis, 40 Minn. 110.

was valid between the various parties when made, and was a continuing contract with them in their corporate name as soon as formed (note 30, above). So also, where D subscribed a preliminary paper, but with the oral agreement that the subscription should not be delivered until other parties named had subscribed, but which was in fact used to secure other subscriptions, he was liable, although the parties named never subscribed, and D did not know the paper had been so used, or delivered to and acted upon by the corporation. Under these last two theories withdrawal requires the unanimous consent of the subscribers.

§ 55. **Subscription to promoter or trustee.** If made to a statutory promoter, as a commissioner or incorporator, it is a binding contract from the time of making; if made to a self-constituted trustee, who is to organize the corporation, deliver the subscription list to the corporation, and deliver certificates of stock to the subscribers, it is a binding contract between the promoter and subscribers, in accordance with its terms, from the time it is made; he has a right to enforce it, if he performs his part (31a); and when it is delivered to the corporation and accepted by it, the corporation can enforce it (32).

§ 56. **Underwriting.** This is a form of subscription entered into before subscriptions are called for from the public, whereby, for an agreed commission or profit, the underwriters undertake to take all the shares, except what the public subscribes for after the books are regu-

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(31a) San Joaquin Land Co. v. West, 94 Cal. 399.

(32) West v. Crawford, 80 Cal. 19.

larly opened and subscriptions called for (33). If properly drawn it is an enforceable contract from the time it is made.

§ 57. **Application, allotment, and notice.** Under the English law an application for shares is made to the promoters, very similar to our subscriptions to stock in a corporation to be formed; after the subscription books are closed, the promoters make allotment among those who have subscribed, either pro rata, or in such way as the promoters deem for the best interests of the corporation. After allotment is made, the subscriber must be notified of the number of shares alloted to him; the contract is not complete until then; before that time it is a mere withdrawable offer.

§ 58. **Conditional subscriptions.** Subscriptions may be upon conditions: (1) Express or implied; (2) precedent or subsequent; (3) before or after incorporation; (4) or the delivery of the subscription may be conditional.

§ 59. **Express and implied conditions.** Express conditions may be found either in the subscription, or in the statutes relating to subscription; the former may be of infinite variety, if not inconsistent with the charter; the most usual condition found in statutes is that payment of a certain amount shall be made at the time the subscription is made; if such subscription is made before incorporation, two views are taken as to the necessity of payment under such a statute—one that it is necessary, and failure to pay makes the subscription void; the other (supported by the weight of authority) is that such pro-

(33) Electric Welding Co. v. Prince, 195 Mass. 242.

vision is meant for the benefit of the corporation only, and it may waive it if it chooses. The principal implied condition, attaching to subscription at common law, is that no one can be called on to pay anything to the corporation for carrying on its business until the whole amount of stock agreed upon is fully subscribed.

§ 60. **Conditional subscriptions prior to incorporation.** If these are necessary for purposes of organization, two views are held: the New York view, that they are entirely void, and cannot be counted; and the Pennsylvania view, which holds the condition to be void, and the subscription absolute, unconditional and valid, so it may be counted as one of the necessary subscriptions. If such conditional subscriptions are not necessary for organization, in either state they would probably be held valid according to their terms.

§ 61. **Conditions precedent and subsequent.** A subscription upon condition precedent is one which requires the condition to be performed, unless waived, before the subscriber can become a member; if made after incorporation two theories exist as to their legal effect: (1) That they are mere withdrawable offers until the condition is fully performed; (2) that they are binding contracts from the time of making, to await the time of performance, and the subscriber cannot withdraw unless the corporation fails to perform. Subscriptions upon conditions subsequent are valid, and have the effect of making the subscriber a member from time of acceptance by the corporation; if the corporation fails to perform the condition, the subscriber cannot withdraw, but has an action for dam-

ages against the corporation for its failure. Courts construe conditional subscriptions to be conditions subsequent if possible (34).

§ 62. **Conditional delivery of subscriptions.** Subscriptions, absolute in form, may be delivered to someone to be delivered to the corporation only upon the happening of some event; if the delivery is made to some one unconnected with the corporation it does not become effective until delivery to, and acceptance by, the corporation; if delivered to an agent of the corporation, one line of authorities holds that the legal effect is the same as if delivered to an outside party, while another line holds that it becomes an absolute delivery to the corporation at once, and the condition is waived.

§ 63. **Fraud and mistake.** These vitiate the subscription the same as in other contracts, and make it voidable at the option of the subscriber. He must, however, be diligent in discovering the fraud or mistake and prompt in repudiating the subscription after ascertaining the fact. The English and some American cases hold that, even if the subscriber has acted with due diligence, he cannot repudiate the subscription after insolvency and creditors' rights have intervened (34a); others hold he can if he is not guilty of laches (35).

§ 64. **Parties that may subscribe.** The general rule is that subscribers must be persons capable of contracting, so far as all subscriptions necessary for organization are concerned. An infant may subscribe, but if he does he

(34) Railroad Co. v. Parks, 86 Tenn. 554.
(34a) Oakes v. Turquand, L. R. 4 App. Cas. 615, 2 H. L. 325.
(35) Hinkley v. Oil Co., 132 Ia. 396.

may repudiate the subscription as in other contracts; at common law, the subscription of a married woman was said to be void, but under statutes in most states her subscription is now valid; an alien friend or non-resident, or person of any nationality or vocation may subscribe; neither private nor public corporations can subscribe for shares unless specially authorized; in the absence of constitutional provisions forbidding, the state or nation, by legislative permission, may subscribe for stock in public service corporations, but not private manufacturing companies. The statutes now often permit one corporation to acquire by original subscription or purchase the shares of other corporations.

Section 5. Organization.

§ 65. **Schemes of organization.** As before indicated, under a king's charter, or a special act, or a deed of settlement, the organization was distinctly set forth in the instrument itself, and usually the persons who were to act as the first officers were designated; methods of continuing the succession were also specifically provided. Under general incorporation laws, it is usual for the organization to be completed, before the articles of incorporation are filed, by electing the proper officers and agents, and certificate of this fact is made when the articles are filed with the public officer; in other cases the incorporators call for subscriptions, and, after these have been received, the incorporators call the subscribers together and they elect officers, adopt by-laws, etc., and start the machinery running. In other states more formal proceedings are essential, such as having a hearing be-

fore a court or commission established for the purpose, with a finding of such court or commission entered upon a public record, and sometimes publications thereof made.

§ 66. **Proof of organization.** Usually under general laws a certified copy of the articles of association, filed with the secretary of state and duly certified by him under the great seal of the state, is prima facie evidence of the existence of the corporation; it is, however, usually not conclusive, and the facts of organization may be inquired into. Under special acts, the act itself, or an exemplified copy thereof with evidence of user, was sufficient to establish corporate existence (36). General reputation has been held to be sufficient.

§ 67. **Commencement of corporate existence.** As to the exact time of corporate birth, there are divergent views, based more or less upon the peculiar provisions of the statutes. These are: (1) There is no corporate life until organization is complete; (2) corporate life begins as soon as the articles are filed with the proper officer, without stock subscription or organization; (3) only a qualified corporate existence begins when the articles are filed, and the adult or perfect corporate capacity is not acquired until the stock is provided as required; (4) corporate life begins as soon as the articles are filed, but, until the stock is divided into shares, the incorporators are tenants in common of the proposed capital; (5) under special acts, the statute may make those named, ipso facto and eo instanti, a corporation without further act on their part. Thus, where the statute required the names of the

(36) Mokelumne Hill, etc. Co. v. Woodbury, 14 Cal. 424.

directors for the first year to be stated in the articles of association, and provided that the "existence of the corporation should date from the filing of the articles with the secretary of state," and this was done, yet it was held that it was not in existence before the stock was subscribed, and a full and complete organization perfected, and those who incurred obligations in the name of the corporation were personally liable (37). On similar facts it was ruled otherwise in South Dakota (38). In another case on like facts it was held that those who participated in incurring the obligation, or were careless in permitting it to be incurred before organization was complete, were personally liable, since a "corporation" without organization was like "the hull of a ship, without rudder or masts or gearings" (39).

§ 68. **Conditions of de jure existence.** A substantial (but not necessarily literal) compliance with all mandatory conditions of the general law is essential to de jure existence, that is, such as will avail against the direct assault of the state. The implied condition that there must be good faith in seeking corporate powers is mandatory; mandatory express conditions are: (1) that there shall be a certain number of incorporators; (2) written articles of agreement; (3) giving the names and residences of subscribers to stock if that is required; (4) naming place of business; (5) stating definitely the purpose or purposes; (6) subscribing articles of association; (7) acknowledging them; (8) filing them as required by law;

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(37) Walton v. Oliver, 49 Kans. 107.

(38) Singer Mfg. Co. v. Peck, 9 So. Dak. 29.

(39) Wechselberg v. Flour City Bank, 64 Fed. 90.

all these have been held to be matters of which the state may complain if not substantially followed. Some conditions however are merely directory, as where the statute provided that the first meeting of the incorporators should be called by a majority of the persons named in the act of incorporation, the meeting was called by only one of the incorporators, and all were notified and attended the meeting, the corporation was validly formed (40). So some conditions are *subsequent,* as where the statute provided that before a corporation could *commence business,* the president shall cause the articles of association to be published, and a certificate thereof to be deposited with the secretary of state, and a duplicate with the clerk of the court, the making and depositing of the certificate was not a condition precedent to corporate existence, but a condition to the lawful carrying on of business after incorporation (41).

§ 69. **Conditions of de facto existence.** Something less than a substantial compliance with all mandatory provisions will suffice for de facto existence, i. e., such as is valid as against any one but the state. The following are conditions of de facto existence: (1) A valid law under which such a corporation could be formed; (2) a bona fide attempt to organize under the law; (3) an apparent compliance therewith; and (4) corporate user. When these things concur, by the weight of authority, no one but the state can successfully question the corporate existence, and then only in a direct proceeding for

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(40) Newcomb v. Reed, 12 Allen (Mass.), 362.
(41) Harrod v. Hamer, 32 Wis. 162.

that purpose. The matter however is very much involved, and the courts do not seem to follow any settled doctrine. Much of the confusion arises from the great variety of opinion that exists as to the necessity of pleading and proving corporate existence, and the presumptions relating thereto. These are noted elsewhere.

§ 70. **Conditions of existence by estoppel.** Estoppel is founded in the obligation which every man is under to speak and act according to the truth of the case; so, wherever an act is done by a party which cannot be contravened or contradicted without fraud or misconduct on his part, and such act has induced another to believe in the existence of a fact or condition and thereby to change his position, the party who did the act is not permitted to show the contrary. It does not shut out the truth, but rather lets in the whole truth. If persons, therefore, have acted as if a corporation were in existence, in such a way as to recognize it to be such, where it is equitable (42) to hold them to such recognition and inequitable (43) not to do so, they will be estopped to deny such corporate existence, even though it is really neither a de jure nor a de facto corporation. This seems to be the rule by the weight of authority, but there are many cases to the contrary; a different view is that there can be no estoppel upon a matter of law, and hence if there is no law, or an unconstitutional law, there can be no estoppel; still another view is that there can be no estoppel unless there is at least de facto existence; still another view is that

(42) Doyle v. Mizner, etc., 42 Mich. 332.

(43) Estey Manufacturing Co. v. Runnels, 55 Mich. 130.

it is against public policy to allow persons to claim corporate existence unless they have substantially complied with a valid law; hence there can be no recognition of corporate existence arising merely by estoppel, even against the pretended corporation itself (44).

§ 71. **Parties estopped.** Where existence by estoppel is recognized, the parties estopped to deny corporate existence are: (1) The pretended corporation itself; (2) those who act as, or claim to be, members, either among themselves, or in regard to their liability upon their subscription, or statutory liability to corporate creditors (45); (3) the promoters and officers of the apparent corporation; (4) persons who have dealt with the apparent corporation in such a way as to recognize it to be such, either when they seek to avoid their liability to it, or to hold its members liable as partners (46); but dealers with such pretended corporation, without knowledge that it claims to be such, are not estopped to deny it is a corporation; (5) persons who have injured such corporations by their torts or crimes, when called to account, are also estopped.

§ 72. **Effect of failure to comply with conditions.** (1) The state may complain for failure substantially to comply with any mandatory conditions in quo warranto proceedings and prevent further action as a corporation. (2) If there is neither de jure nor de facto existence, a

(44) Boyce v. Trustees of M. E. Church, 46 Md. 359.

(45) Canfield v. Gregory, 66 Conn. 9; McCarthy v. Lavasche, 89 Ill. 270.

(46) West Winsted Sav. Bk. v. Ford, 27 Conn. 282; Snider's Sons' Co. v. Troy, 91 Ala. 224.

person not estopped for other reasons can question the validity of the pretended corporate existence in any proceeding in which it is of any importance to him to have it determined. (3) If there is de facto existence (except as against the state), the powers, rights, duties, and liabilities of the corporation and its members are the same as if de jure. (4) And where there is neither a de jure nor a de facto corporation, as to a party otherwise estopped by his own acts, the corporation is to him the same as it would be if it were de jure. (5) But to one not so estopped, by one line of authority he may treat the members (if it is for a business purpose) as if they were partners (47), and by another hold them as members of an unincorporated association (48)—the liability resting only upon those who have participated in the acts, or authorized them to be done, or ratified them.

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(47) Martin v. Fewell, 79 Mo. 401.
(48) Fay v. Noble, 7 Cush. (Mass.) 188.

CHAPTER III.

THE BODY CORPORATE.

SECTION 1. MEMBERS, INTEGRAL PARTS, AND ORGANS OF ACTION.

§ 73. **Necessity of members.** In a corporation aggregate there must be members, otherwise it cannot exist. If it is a non-stock company, the death of all the members terminates the existence; but, if it is a stock company, the representatives of deceased members who succeed to the shares become members, and consequently the corporation is not dissolved. A practice has lately grown up whereby a corporation purchases and retires its own shares of stock. When that is done, if all shares are so retired, it would seem the corporation would be dissolved. No case, however, has yet been decided so holding. The ownership of all the shares by one member does not dissolve the corporation (1), although it has been said that, for some purposes, the corporate existence is suspended until other persons become members by becoming owners of some of the shares, but this is not according to generally received views.

§ 74. **Acquisition of membership.** Membership in non-stock companies is obtained by complying with the con-

(1) Louisville v. McAteer (Ky.), 81 S. W. 698.

ditions set forth in the constitution and by-laws. In stock corporations, membership is acquired through ownership of stock and this may be: (1) subscription to the stock accepted by the corporation; or, (2) by a completed transfer of shares; or, (3) in some cases, by estoppel such as acting or holding one's self out as a member without in fact having subscribed. We have already considered acquisition of membership by subscription. Transfer of shares is considered below. Where one held himself out as a member of a corporation and allowed the pretended corporation to incur obligations, the member was estopped to allege the corporation was illegal because the law under which it was formed was unconstitutional (2).

§ 75. **Integral parts.** Sometimes one corporation is composed of two groups of individuals in such a way that the continuance of both is essential to the continued corporate existence; if, therefore, from any cause all of one group should die, and there was no method of supplying their place, the corporation would necessarily be dissolved. It was once contended that directors were such an integral part, but the cases have decided otherwise. It is not usual now to find a corporation created with integral parts, although St. Mary's church in Philadelphia is said to be so created.

§ 76. **Organs of action.** Since a corporation is an artificial entity, it can act only through representatives. These are: (1) The majority of a quorum of corporate members duly assembled in corporate meeting; (2) a majority of directors duly assembled in directors' meet-

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(2) McCarthy v. Lavasche, 89 Ill. 270.

ing; (3) officers of the corporation who are considered parts of the organization; (4) agents, who are not considered parts of the organization but who represent it as any agent does his principal; and (5) servants, who do not represent it but simply work for it. For example, where a minister, without a formal meeting of the church trustees so directing, solicited subscriptions on Sunday to complete the church, the names and amounts being written down by a clerk as they were announced, a subscriber could withdraw at any time before the trustees met and accepted the subscription list, or ratified the act of the minister, since he was not duly authorized before that time (3).

§ 77. **Qualifications of agents and officers.** Unless statute or charter prevents, a corporation may select any persons it pleases to be its officers, agents, or servants. It is usual either by statute, charter, or by-law provision, to require directors to be shareholders and in some states they are required to be citizens of the United States.

§ 78. **Functions of shareholders and directors.** Shareholders wield the extraordinary and unusual powers, such as electing directors, accepting and rejecting amendments, increasing and reducing the capital stock, making by-laws, admitting members, and in some circumstances removing officers or restraining ultra vires transactions; disposing of all the corporate property; winding up the corporate business or surrendering the corporate franchises, and dissolving the corporation (4). The directors

(3) Methodist Church v. Sherman, 36 Wis. 404.

(4) Metropolitan Elevated Ry. Co. v. Manhattan El. Ry. Co., 11 Daly (N. Y.) 373.

control the ordinary business affairs, such as the policy of management; the expediency of acting or contracting; and the selection of inferior officers, fixing their compensation, directing their actions, etc. Within this scope of their authority, if they act in good faith, the stockholders cannot dictate to them nor control their acts in any particular; the stockholders must wait until time for a new election for selecting such directors as will conform to their wishes, unless the power of removal of officers has been reserved to the shareholders by statute, charter, or by-law provisions.

§ 79. **Functions of other officers.** The *president*, merely as president, presides over corporate meetings and has no greater power in managing the corporate business than any other shareholder; but, by statute, or charter, or by-law, or by a course of action acquiesced in by all, he is usually given the power to represent the corporation in most of its ordinary business transactions. He usually executes conveyances, and signs contracts and certificates of stock. The *vice-president* performs the function of the president, when he is unable to perform his duties. The *secretary* keeps the minutes, records of corporate meetings, and has no other duties unless specifically conferred upon him. He is usually made the custodian of the corporate seal, and is required to attest it and affix it to all documents executed by the corporation. He frequently is allowed to issue shares, and is often made the transfer agent of the corporation. The *treasurer* is custodian of the corporate funds, and has power to endorse checks for collection by the corporation.

He is sometimes said to have implied authority to draw checks or bills of exchange, or sign promissory notes for money borrowed by the corporation, but it is doubtful if he can do this without special authority. The corporation can select such other officers and agents and confer such authority upon them, within the corporate powers, as may be necessary or convenient, subject to the general rule that directors should not delegate to others their directionary powers and duties (5), although some cases hold that this may be done under a general authority "to appoint such subordinate officers and agents as the corporation may require" (6).

SECTION 2. INTERNAL RELATIONS.

§ 80. **Contracts contained in the charter: Dartmouth College case.** In 1769 the king of England incorporated twelve persons by the name of Trustees of Dartmouth College, and granted to them and their successors the usual corporate powers, and also authority to fill up any vacancies which might occur in their own body. In 1816, the legislature of New Hampshire attempted to amend the charter by increasing the number of trustees to 21—the nine additional members to be appointed by the governor—and also by putting over the trustees a board of overseers, with power to inspect and control the most important acts of the trustees. The corporation refused to accept the amendment, and brought suit for the conversion of its corporate seal and records by those who took possession under the amendment to the charter; the

(5) First National Bank v. Commercial Assn., 185 N. Y. 575.
(6) Sheridan Light Co. v. Chatham Bank, 127 N. Y. 517.

supreme court of New Hampshire sustained the legislation, but the case was taken to the Supreme Court of the United States, where it was held, reversing the New Hampshire decision, that the charter constituted a contract originally between the king and the corporation, and, after the American Revolution, between New Hampshire and the corporation; and that contract was one the obligation of which could not be impaired by the state of New Hampshire without violating the provision of the national Constitution: "No state shall pass any law impairing the obligation of contracts" (7).

§ 81. **Same: Variety of charter contracts.** From this case, has grown up a great body of corporation law. Resulting from this decision it has been held that in the formation of a corporation there are: (1) A contract between the state and the corporation; (2) a contract between the state and corporate creditors; (3) a contract between stockholders and corporate creditors, in the case of a special statutory liability; (4) a contract between the state and the corporators or members; (5) a contract between the corporation and the members, or among the members themselves, as to the amount to be contributed, or that subscriptions are made in good faith. All these contracts, whether express or implied, are protected by the constitutional provision. For example, where the statute under which the corporation was formed provided that stockholders should be individually liable for corporate debts to double the face value of the shares, this liability could not be taken away, so as to divest a

(7) Trustees of Dartmouth College v. Woodward, 4 Wheat. 518.

prior creditor of the right to resort to this fund for payment in case the corporation could not pay—there is an implied contract between the state and the existing corporate creditors which cannot be annulled by the state alone (8). So, too, on the other hand, when a person has become a shareholder in a corporation in which there is no individual statutory liability of the shareholders to the creditors, the state cannot, unless the right to amend is reserved, impose such a liablity on the existing shareholders without their consent (9).

§ 82. **Same: Effects of the doctrine.** The Dartmouth College decision has been severely criticised from time to time by writers and judges, but, while reasonably definite limits to it have been worked out by later decisions, "the original doctrines of the case have become so imbedded in the jurisprudence of the United States as to make them to all intents and purposes a part of the Constitution itself," and have given "solidity and invioliability to the literary, charitable, religious, and commercial institutions of our country." Although for a time, "it was under the protection of this decision that the most enormous and threatening powers in our country have been created," yet, for the most part, under the reservation in state constitutions of the power to repeal or amend corporate charters without let or hindrance, most of the danger threatened has been obviated or averted.

Under this decision all vested property rights acquired by executed contract, as well as all such rights as are

(8) Hawthorne v. Calef, 2 Wall. 10.

(9) Ireland v. Turnpike Co., 19 Oh. S. 369.

necessary to the full and complete enjoyment of the original grant, or of property legally acquired subsequent to the grant, are protected. So too, any valuable privilege, such as an exemption from taxation, or an exclusive right to supply water or gas, or to occupy streets for railway purposes, or that the bills or notes of the grantee shall be received for taxes, given by the corporate charter, and which conduced to the original acceptance of it, is protected by the constitutional provision.

On the other hand, since grants by the state are strictly construed against the grantee, an exclusive grant is never presumed, a tax exemption does not extend to property not used or not necessary, police regulations necessary for the preservation of the public safety, health, and morals are not forbidden, laws authorizing municipal subscriptions, not yet actually made, may be repealed, unnecessary and unexecuted contingent privileges, such as an unexecuted right to consolidate in the future, and subsequent grants not supported by a good consideration, may be revoked without violating this constitutional provision (10). For a full discussion of the doctrine of the Dartmouth College case, see Constitutional Law, §§ 230, 236-42, in Volume XII of this work.

SECTION 3. CORPORATE FUNDS.

§ 83. **In general.** By incorporation for business purposes there is a *dedication* of certain funds by the implied and express command of the state and the corporators to the attainment of certain purposes in a certain

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(10) Pearsall v. Great Northern Ry. Co., 161 U. S. 646.

way. Because the state believes the purposes desirable, it authorizes the peculiar method; because the corporators deem the method necessary or desirable and the purpose profitable, they contribute the funds; the peculiar method is by the state authorizing a changing body of persons, through a specified form of organization and under a designated name, to act and be considered as one person, in whom are vested the funds, and upon whom is placed the duty of applying them to the purposes named. These funds are designated capital or capital stock.

§ 84. **Capital and capital stock.** There is much confusion in the use of these terms. The best usage, however, is to say the capital of a corporation is the whole amount of its property of whatever kind, and to say that capital stock is the amount which it has obtained or is authorized to obtain by way of subscription (11). The latter is the sum fixed by the corporate charter as the amount paid in or to be paid in by the subscribers for the prosecution of the business and for the benefit of the corporate creditors.

§ 85. **Purpose of capital stock.** Corporations acting through their proper officers, within the scope of corporate powers, fix no liability on their officers or on anyone else than the corporation itself. Hence the purpose and policy of requiring a capital stock as security and indemnity for persons who become its creditors; the law-making power confers upon the members a privilege—a franchise—a right to make contracts in its artificial name without fastening a liability on any natural person; and it

(11) People v. Coleman, 126 N. Y. 433.

exacts from them, as a condition on which it grants this franchise, that they place a capital stock in safe pledge for the security of their creditors. This is a permanent investment, with no power in a shareholder to withdraw it until the corporation is wound up and all its debts paid, and with no power in the managing board to permit it to be withdrawn at the expense of creditors. It is looked upon as a trust fund for the benefit of the corporation and its members, and the protection of corporate creditors. The capital stock "is the aggregate amount of the funds of the corporators, which are combined together under a charter for the attainment of some common object of public convenience or private utility. This amount is usually fixed in the act of incorporation. It is thus limited in reference to the convenience of the intended corporators, and for the information and security of the public at large. To the corporators, it prescribes the amount and subdivisions of their respective contributions to the common fund; the voice which each shall have in its control and management; and the apportionment of the profits of the enterprise. To the community it announces the extent of the means contributed and forming the basis of the dealings of the corporate body, and enables every man to judge of its ability to meet its engagements and perform what it undertakes. The capital stock is like that of a co-partnership or joint stock company, the amount which the partners or associates put in as their stake in the concern. To this they add, upon the credit of the company, from the means and resources of others to such extent as their own prudence

or the confidence of such other persons will permit. Such additions create a debt; they do not form capital, and, if successful in their career, the surplus over and above their capital and debts becomes profit, and is either divided among the partners and associates. or used still further to extend their operations" (12).

§ 86. **Capital stock, franchise, surplus, and shares of stock.** These are different things. The capital is the money or property, or both, of the corporation; the shareholders' shares are representative of the capital, the surplus, the dividend earning power, the franchises, and the good will. The capital stock of the company is owned and held by the company in its corporate character; the share capital stock of the shareholders, they own and hold in different proportions as individuals; the one belongs to the corporation, the other to the corporators. The *franchise* of the company, which may be deemed its business opportunity and capacity, is the property of the corporation, but constitutes no part or element of its capital stock, while the same franchise does enter into and form part, and a very essential part, of the shareholders' capital stock. While the nominal or par value of the capital stock and of the share stock are the same, the actual value is often widely different. The *capital stock* and *surplus* differ also. The capital stock of the company may be wholly in cash or in property, or both, which may be counted and valued. The company may have, in addition, a *surplus,* consisting of some accumulated and re-

(12) Sanford, V. C., in Barry v. Merchants' Exchange, 1 Sand. Ch. (N. Y.) 280.

served fund, or undivided profits, or both, but that surplus is no part of the company's capital stock, and therefore, is not itself capital stock. Neither the capital nor capital stock can be divided and distributed, but the surplus may be, yet that surplus does enter into and form part of the share stock, for that represents and absorbs into its own value surplus as well as capital, and franchise in addition. So it may be said that the property of a corporation consists of three things, which are its capital stock, its surplus, its franchise; but these three things, distinct in the ownership of the company, are united in the ownership of the shareholders. The share stock covers, embraces, represents, all three of these in their totality, for it is a business photograph of all the corporate possessions and possibilities (13). Hence, where the statute requires the "capital stock and the surplus" of a corporation to be taxed, the value of such cannot be determined by taking the aggregate market value of the outstanding shares, for such would include the value of the franchise and good-will also. There is however much confusion in the taxing laws in the use of the terms "capital," "capital stock," and "property," and the cases cannot be reconciled.

§ 87. **Kinds of shares of stock.** Shares are of various kinds, such as common, preferred, guaranteed, interest-bearing, treasury, deferred, founder's shares watered, fictitious, or spurious.

Common shares entitle their owners to an equal pro-

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(13) Largely quoted from Judge Finch in People v. Coleman, 126 N. Y. 433.

portional participation in the management and profits, during corporate life, and in the net assets in case of dissolution. *Preferred* shares entitle their owners to some preference in the distribution of profits or of assets over the owners of the common stock. They may be either cumulative or non-cumulative as to profits, up to a certain fixed amount; if cumulative, a deficiency in paying the dividend for one year must be made up out of the profits of succeeding years. In the absence of express provision making preferred stock *cumulative* there is a tendency to hold it, nevertheless, to be so, but this is not so strong as to make it entirely certain it will be so held, where it is not really so expressed. Preferred shareholders usually have a right to participate in the management, and are subject to liabilities, as other shareholders. "Six per cent cumulative preferred," means that the owner of such shares will receive six per cent on the face value of his shares before the common shareholders receive anything. In case in any one year there is enough profit to pay only three per cent on the preferred shares, then, in the subsequent years when there are sufficient profits, the preferred shareholder will be entitled not only to the six per cent for those years, but also to all arrears in the payment of the dividends of previous years, before the common shareholders are paid dividends (14). After the preferred shareholders have been paid in full, if there is then a surplus, this may be divided among the common shareholders even though they will thereby re-

(14) Roberts v. Roberts, etc. Co., 184 N. Y. 257; Jermain v. L. S. & M. S. Ry., 91 N. Y. 483.

ceive much more than the six per cent paid to preferred shareholders—unless the preferred shares are made *participating* in the profits, after the common shares receive a dividend equal to the preference dividend. Preferred dividends are not *debts,* like interest, and to be paid at all events, but are to be paid only out of profits (15), when they have been duly declared as dividends by the proper authorities (16). Neither is a preferred shareholder a *creditor* of the company, even though his shares so state, so as to give him claim prior to that of unsecured creditors (17), unless the statute so authorizes (18). *Guaranteed* shares in the United States now mean substantially the same as cumulative preferred shares. *Interest-bearing* shares are such as bear interest upon all sums paid in, until the corporation is completed and profits are earned out of which to pay dividends. Such payment out of capital instead of profits, however, is held to be illegal as against creditors who might be injured thereby.

§ 88. **Same (continued).** *Treasury stock* is often stated to be that part of the authorized stock left in the possession of the corporation to be issued in the future by the corporation or upon further subscription. The term, however, is more properly used to designate stock that has once been issued, but surrendered or forfeited to the corporation, and afterward re-issued or sold by it. It cannot be voted nor does it draw dividends while

(15) Lockhart v. Van Alstyne, 31 Mich. 76.
(16) N. Y., etc. Ry. Co. v. Nickals, 119 U. S. 296.
(17) Hamlin v. Trust Co., 78 Fed. 664.
(18) Heller v. Natl. Bk., 89 Md. 602.

held by the corporation. In recent years, a practice has grown up, particularly in speculative ventures such as involve mining and patent properties, for the owner of the mine or patent to organize a corporation with a certain authorized amount of capital stock, in exchange for all of which the mining property or the patent right is to be conveyed to or accepted by the corporation, in full payment for the whole of the stock, the directors usually passing a resolution that in their judgment the value of the property to the corporation is equal to the value of the stock. The person to whom the stock is so issued then generally is to, and does, donate to the corporation a certain part of the stock received by him as treasury stock fully paid, to enable the corporation to sell it at the best price that can be obtained for it, in order to get the money —"working capital"—aetually necessary to start and carry on operations. The buyer of such shares takes as a *purchaser,* and not as an original *subscriber,* and, in the absence of fraud, is not liable to pay any more than the purchase price, even though this is much less than the face value. Such a procedure has been held valid, if there is no fraudulent purpose or over-valuation of the property, and creditors are not thereby injured (19).

Deferred stock draws no dividend until some one class of shares receive their dividends. They are practically common shares. *Debenture-stock* is not stock at all in our American sense, but rather a bond, the holder of which is a creditor and entitled to interest, and it is issued in

(19) Lake Superior Iron Co. v. Drexel, 90 N. Y. 87; Iron Co. v. Hays, 165 Pa. St. 489.

such a way that any fraction of it may be transferred. *Founder's shares* entitle the holder to all the profits, after certain fixed maximum dividends are paid to the other shareholders. *Watered stock* is that which upon its face purports to have been paid for at its full value, but which in fact has been issued without the corporation having the right to demand the full face value thereof. *Fictitious shares* are substantially the same as watered shares. *Spurious stock* is that issued in excess of the amount authorized. It is void, and the holder does not become a member of the corporation.

§ 89. **Right to create capital stock.** The power to create, increase, or decrease, capital stock is a franchise which can be exercised only under the authority of a legislative grant (20). At the time a corporation is organized, however, it may provide for both common and preferred stock, and call for subscriptions for either; if the corporation is first created, and the stock subscribed upon the understanding that only common stock shall be issued, by the weight of authority the corporation cannot (except by unanimous consent of shareholders) create shares that shall have a preference over the common shares (21). By express legislative authority, however, it has been held that the majority of members, contrary to the wishes of the minority, may issue preferred shares; it is said to be analogous to borrowing money and the majority certainly have the right to do that, if done in good faith.

(20) Cook v. Marshall, 191 Pa. St. 315.
(21) Campbell v. Zylonite Co., 121 N. Y. 455.

§ 90. **Nature of shares of stock.** A share of stock is an intangible property right to participate in the profits of the corporation, and, in the event of dissolution, to participate in the division of assets after debts are paid. Such shares are personal property, goods, wares, or merchandise within the seventeenth section of the statute of frauds, and choses in action. They are not negotiable instruments, and at common law could not be taken by attachment, or on execution, or in replevin, because of their incorporeal nature. By statutes in most of the states provision is made for attaching shares of stock or taking them upon execution, by notifying the company not to transfer them otherwise than as directed by the court. They are usually considered as being located at the domicile of their owner, though the state may give them a situs at the domicile of the corporation (22). They are evidenced by a certificate which usually says: "This is to certify that A. B. is the owner of Ten Shares of the Capital Stock of X Company of the par value of $100 each, fully paid up and transferable only upon the books of the corporation upon surrender of this certificate duly endorsed." This is usually signed by the president, and countersigned by the secretary under the seal of the corporation. Upon the back is usually a form of assignment which will read: "For value received, I hereby assign and transfer all my right, title, and interest to the shares in X Company, evidenced by this certificate, to Y, and I do hereby irrevocably appoint Z to be my agent, or attorney in fact, for me, and in my name, to have the trans-

(22) Plimpton v. Bigelow, 93 N. Y. 592.

fer of the same made upon the books of the corporation." This will be signed by A. B. and delivered to Y. It is not necessary to fill in the name of the purchaser, nor the name of the attorney, to make the transfer. These may be left blank and then, after delivery of the certificate to Y, the purchaser, he may, by mere delivery of the certificate, sell it to some one else, and this party to another, and so on; the last purchaser may fill in his own name and the name of any proper person to have the transfer made on the books of the company, who can then take the certificate to the corporation, surrender it, have the transfer made to the purchaser upon the books, and receive a new certificate in the name of such purchaser.

Section 4. Corporate Name.

§ 91. **Necessity of a name.** It was said long ago that names of corporations are given of necessity, for the corporate name is as a baptismal name, and the very being of their constitution, "and though it is the will of the king that erects them, yet the name is the knot of their combination, without which they could not perform their corporate acts." Such is the rule yet.

§ 92. **Acquisition of a name.** A name is usually given in the charter or articles of association, and the law now generally requires it to be so given; and sometimes specific and definite provisions exist which must be carefully followed; but in the absence of specific provisions, it is not perhaps indispensable that it should be so given; it may be derived from usage. The corporation perhaps cannot select a name already in use by another corporation organized in the same state.

§ 93. **Rights in the corporate name.** If lawfully acquired, the right to a corporate name is a franchise (23), and the corporation which has acquired a name has the same right to use it as it would a trade mark, and may enjoin its subsequent appropriation and use by another corporation, association, or person, if it would be damaged thereby (24). It has been held, however, that a foreign corporation cannot prevent the use of a corporate name afterwards selected by a domestic corporation; and no exclusive right can be acquired in geographical names. The secretary of state or the proper registering officer has discretionary power to refuse to register a company that chooses a name that too closely resembles one already in use.

§ 94. **Effect of misnomer.** In the case of contracts this has no effect, if the identity of the corporation can be established. In process against the corporation by the wrong name, a suit is not validly begun, but it may be corrected by amendment; if the corporation issue process for itself in a wrong name, it is ground for plea in abatement; slight variations, not misleading as to the identity of a corporation, are not usually material.

§ 95. **Change of name.** The corporate name can be changed only by consent of the state and of the shareholders; such change, if legal, does not affect the rights, duties, or liabilities of the corporation (25). It has been held, however, if the change is illegal, members consent-

(23) Boston Rubber Shoe Co. v. Boston Rubber Co., 149 Mass. 436.

(24) Armington v. Palmer, 21 R. I. 109.

(25) Cincinnati Cooperage Co. v. Bate, 96 Ky. 356. Compare: Neff v. Covington, etc. Co., 108 Ky. 457.

ing thereto are liable as partners afterwards. Statutes usually provide a simple method for changing a corporate name.

SECTION 5. CORPORATE LIFE.

§ 96. **Mode of existence. Perpetual succession.** In the absence of any provision to the contrary the duration of a corporation is perpetual. It is however usual, by constitutional or statutory provisions, to fix a limit to the corporate life. Some statutes require a limit to be fixed in the articles of association. Within the time fixed however the corporation is said to have *perpetual succession*, by which is meant the power to provide other members in the place of those who drop out. In the case of non-stock corporations, this is usually done by the election of other members; in stock corporations, the successor in the ownership of stock becomes a member. For example, the general corporation law provided that "every corporation shall have succession for the period limited in its charter, and, when no period is limited, for twenty years." Afterwards a special act was passed incorporating a gas company with "perpetual succession," with the exclusive right to manufacture gas for thirty years. At the end of twenty years the state brought quo warranto to prevent the corporation from continuing to act as such. Held, corporate life had expired, and that "perpetual succession" meant continuous succession for the twenty years fixed by the general law, and not everlasting existence, or existence for thirty years (26).

(26) State v. Payne, 129 Mo. 468.

§ 97. **Mode of action. Shareholders' meeting.** So far as the members control corporate action, they must do so in a duly called corporate meeting. This meeting must be called by the proper officers; in the absence of other provisions, the directors have this authority; it is usual to put such authority in the hands of the president or secretary. Regular meetings of shareholders are also usually provided for in the by-laws, the time and place being designated there. Where no corporate meeting was held, and the secretary called on a majority of the shareholders individually, and they separately authorized a mortgage of the corporate property to be given, which was executed by the president and two stockholders at the request of the mortgagor, to whom it was delivered to secure a $3000 note given by the corporation for the loan of that sum of money, it was held that such mortgage was not valid (27).

§ 98. **Notice of shareholders' meeting.** At common law, notice of corporate meetings, definite as to day, hour, and place was necessary to be given personally to each shareholder in order to make the meeting valid, as against a shareholder who had no notice, was not present, and complained promptly; and, in the absence of charter, by-laws, or statutory provisions, this is still the rule; the matter, however, is usually regulated by the charter or by-laws; these frequently allow notice to be given by publication, or through the mail. If the meeting is a special one, or the business to be done extraordinary or unusual, the notice must state what the business to be done is,

(27) Duke v. Markham, 105 N. C. 131.

but one who is present and participates in the business, without objecting, is estopped to deny the validity of the meeting. No further notice is necessary of an adjourned meeting, or the business to be done thereat, than the record of the resolution adjourning the meeting, if the time and place are fixed by the resolution; otherwise notice should be given. Since regulations concerning meetings are for the benefit of shareholders, they may waive informalities by attendance and participation, or acquiescence in the results.

§ 99. **Quorum.** At common law if all of an indefinite number of stockholders are duly notified to meet, those who assemble constitute a quorum; but charter, by-law, or statutory provisions now usually require a majority of the shares outstanding to constitute a quorum. It has been held that members may vote by proxy, and in such a case it seems that one member, holding the proxy of enough shareholders to make a majority of the shares, may by himself hold a corporate meeting and elect the officers, providing this meeting was duly called. This is frequently done by corporations organized in New Jersey and in other states with liberal corporation laws. And where there is no provision as to what constitutes a quorum, one member, with the proxies of a few others (not however, with his own stock, constituting a majority of shares), can hold a lawful meeting at the time and place fixed in the by-laws of the corporation, without notifying any other shareholders, although the corporation has been defunct for seventeen years; and the directors so elected at such meeting are validly elected, since

due notice is given in the by-laws, and since, at common law, those who attend, one or many, if all are duly notified, constitute a quorum (28).

§ 100. **Place of meeting.** In order to make a valid meeting, against shareholders who do not attend, the meeting must be held within the state creating the corporation (29); but those who attend the meeting held out of the state (30) will be estopped from denying the validity of the action taken. A corporation formed by the consolidation of two corporations, created in different states, may hold a shareholders' meeting in either state (31). So, too, the rule that corporate meetings should be held in the creating state does not apply to non-stock, beneficial organizations. Statutes frequently provide that shareholders' meetings may be held out of the state, if the articles of incorporation so provide.

§ 101. **Directors' meeting.** The directors must also act in a duly called meeting. They have no authority to bind the corporation by their individual acts done outside the corporate meeting (32). The rules as to the notice of meetings are the same as in the case of shareholders. There are cases, however, holding with much reason that a person dealing with a corporation, having no notice to the contrary, has a right to presume that the rules and regulations have been followed by those acting for the company, and, if not, the company is bound anyhow (33).

(28) Morrill v. Little Falls Mfg. Co., 53 Minn. 371.
(29) Miller v. Ewer, 27 Me. 509.
(30) Missouri Lead, etc. Co. v. Reinhardt, 114 Mo. 218.
(31) Graham v. Boston, etc. Co., 118 U. S. 161.
(32) Bank of L. R. v. McCarthy, 55 Ark. 473.
(33) Louisville, etc. Ry. v. Trust Co., 174 U. S. 552, 573.

n the absence of a provision to the contrary, the quorum f the directors' meeting is a majority of all the directors. They vote as individuals and not according to shares, nd cannot vote by proxy. Being agents of the corporaion, there is no necessity to meet within the state, as n the case of shareholders. Exercising delegated power hemselves, it is usual to say that they cannot, without pecial authority, delegate their discretionary duties to n executive committee. There are many cases, however, nd perhaps the weight of authority, to the contrary (34).

§ 102. **Records of meetings.** Corporate meetings, both f shareholders and directors, being deliberative assemlies, should be conducted according to parliamentary sages. It is not necessary to the validity of corporate ctions that records be kept, yet, if they are kept, they re the best evidence of the action taken, and other evilence is not admissible until it is shown that the records annot be obtained. When no records were kept, or they ave been lost or destroyed, oral evidence is admissible o prove corporate actions, and the ordinary presumpions made in other cases apply here.

§ 103. **Execution of contracts.** The contracts of a orporation should be made in the corporate name. Coneyances of land should be to the corporation in its corорate name; so, too, the conveyance by the corporation hould purport to be granted and executed by the corporaion in its corporate name. So, also, notes by the cororation should be signed by the corporate name, and

(34) Sheridan, etc. Co. v. Bank, 127 N. Y. 517; Union, etc. Ry. Co. Chicago, etc. Ry. Co., 163 U. S. 564.

notes payable to the corporation should be made to it in its corporate name. Yet courts often hold contracts and conveyances, not executed in conformity to the foregoing rules, to be the contracts and conveyances of the corporation, when it is entirely clear they were meant to be such (35). Where a deed read "I, Thomas H. Benton, President of the Sulphur Springs Land Company, do hereby convey, etc." and it was signed by Benton in the same way, it was held that this did not pass the title of the land company to the grantee (36). It should have read "The Sulphur Springs Land Company hereby conveys, etc." and should have been signed "The Sulphur Springs Land Co. by Thomas H. Benton, President." The American Bar Association has recommended a form for corporation acknowledgments that is sufficient in most states. The use of the corporate seal is discussed below.

SECTION 6. CORPORATE DEATH. DISSOLUTION OF CORPORATIONS.

§ 104. **Methods of dissolution.** A corporation may be dissolved: (1) By expiration of the time mentioned in the charter. (2) By the happening of a condition or contingency prescribed by the charter to have that effect. (3) By death of all the members in the case of non-stock corporations; but in the case of a stock corporation the shares of the deceased members are distributed as personal property, and consequently the successor in ownership becomes a member, and the corporate life is not

(35) Rawlings v. Gas Light Co., 105 Tenn. 268.
(36) Zoller v. Ide, 1 Neb. 439.

affected. (4) By the loss of an integral part (in case of corporations consisting of integral parts), without the power to replace such integral part. (5) By a surrender of the franchise, accepted by the state. It is both said and denied that acceptance by the state is essential to the dissolution; this is usually now provided for by a general law prescribing a method whereby this may be done. Mere non-user or insolvency of the corporation does not alone amount to a dissolution (37). (6) By repeal of the corporate charter by the legislature, when the state has reserved such power. (7) By forfeiture of the corporate franchise, by a proceeding in the courts for that purpose, because of non-user or misuser of the franchise granted.

§ 105. **One man companies.** In the case of stock corporations, there is usually nothing to prevent one member from acquiring all the shares of stock. By the weight of authority, if the corporation was validly created, the fact that one person acquires all the stock in good faith has no legal effect upon the continued corporate existence; acting in the corporate name and through the corporate officers, the action taken is corporate action (38). And, on the other hand, the individual acts of the sole owner do not bind the corporation; though the individual owner might himself be estopped to deny that such action was in effect corporate action. In Maryland and Kentucky, it has been held that the ownership of stock by one person virtually suspends corporate existence during such sole

(37) Slee v. Bloom, 19 Johns. (N. Y.) 456.

(38) Durlacher v. Frazer, 8 Wyo. 58; Chase v. Tel. Co., 121 Mich. 631.

ownership. And in equity, or in cases of fraud, or evasion of corporate duties, the acts of all the shareholders or a single shareholder owning all the stock, may be treated as the acts of the corporation if necessary to work out justice (39). As, for instance, where a sole shareholder in a corporation without creditors set fire to the corporate property, there could be no recovery upon the insurance policy (40).

§ 106. **Effect of dissolution** (41). (1) The corporate franchises can no longer be exercised. (2) Involuntary dissolution at common law extinguished executory contracts, and no damages could be recovered for non-performance. In equity and by statute, in most states, the obligation of such contracts survives, and may be enforced against the corporate assets, and it is said that voluntary dissolution does not extinguish such contracts. (3) At common law, debts due to or from the corporation were extinguished; but now such claims are preserved in equity and generally by statute. (4) Personal property at common law, upon dissolution, vested in the crown or state; but now it is preserved as an asset for the payment of creditors, or, after payment of creditors, for distribution among the shareholders (42). (5) Real property, at common law, reverted to the grantor; but now a corporation whose duration is limited may take or grant an estate in fee; and, upon dissolution, all real property

(39) Bundy v. Ophir Iron Co., 38 Oh. St. 300.

(40) Meily v. Insurance Co., 148 Fed. 683.

(41) State Bank v. State, 1 Blackf. (Ind.) 267; In re Higginson [1899], 1 Q. B. 325.

(42) Bacon v. Robertson, 18 How. 480.

then belonging to the corporation becomes assets for the payment of debts and distribution among shareholders, there being no reversion either to the grantor or to the state in the case of private business corporations (43). In eleemosynary and non-business corporations the common law doctrines of the escheating of personal property to the state and reversion of real property to the grantor are applied (44), though this has recently been denied (45). (6) Actions by a corporation at common law abate upon its dissolution, but statutes usually now prevent such a result by allowing the representative of the defunct corporation to continue the suit in its place. At common law no valid judgment could be rendered against a dissolved corporation, and attachment and garnishment proceedings were terminated by a dissolution. Statutes now usually provide that dissolution shall not abate pending suits, nor prevent the bringing of suits within a certain time against the defunct corporation (46). Upon dissolution, either by voluntary surrender of the charter, by repeal, or by forfeiture, statutes usually provide either that the corporation itself shall continue to exist for a certain time, in order to wind up its affairs, or a receiver shall be appointed for such purpose.

In the case of public service corporations which are dissolved, or to be dissolved, a receiver is appointed to take charge of the property and continue its operations for the

(43) Wilson v. Leary, 120 N. C. 90.

(44) Titcomb v. Mut. Ins. Co., 79 Me. 315: Mormon Church v. U. S., 136 U. S. 1.

(45) Huber v. Martin, 127 Wis. 412.

(46) Shayne v. Post Pub. Co., 168 N. Y. 70.

benefit of the public, until a re-organization can be made by forming a new company to take over the property discharged of its debts. Usually the property is sold, under foreclosure of some mortgage lien, to a committee who purchases for the benefit of the lienholders, who have agreed upon some plan of organizing a new company to carry on the business, the stock and bonds of which will be issued to the former creditors and shareholders, in proportions agreed upon in the re-organization plan.

CHAPTER IV.

CORPORATE POWERS AND LIABILITIES.

SECTION 1. POWERS IN GENERAL.

§ 107. **Theories of corporate capacity.** There are two of these: (1) Special capacities; (2) general capacity. The doctrine of special capacities is that corporations have such powers, and only such, as are expressly granted or necessarily implied from those granted; all others are excluded. The doctrine of general capacity is that a corporation once duly created has all the powers and capacities of a natural person, so far as they can be exercised by an artificial person. While the rule of special capacities is almost universally adhered to in this country, there is a tendency in the decisions of the state courts, where no public interest or policy is specially involved and creditors' rights are not affected, practically to allow a general capacity to do everything in every way that an individual could do within the field covered by a business in which the corporation was organized to engage (1). Where the corporate charter authorized the company "to make contracts and engagements with other corporations or with individuals for the transporting or conveying of freight and passengers," the company

(1) Hemick v. Hardware Co., 73 Neb. 809.

leased its railroad and rolling stock to another company for twenty years at a fixed rental per year, with a power in the lessor to terminate the lease at any time, the damage done thereby to the lessee to be assessed by arbitrators. The lessor terminated the lease. The damages were assessed for the loss of the unexpired term at $150,000, which the lessor refused to pay. Held, the lessor not liable, as, under the doctrine of special capacities, the company had only such powers as were expressly conferred, and the charter provision above given only referred to traffic contracts for the through transportation of freight and passengers (2). On the other hand, where a corporation was organized "to make, sell, or lend on hire railway carriages and rolling stock, and carry on the business of mechanical engineers and general contractors," under the doctrine of general capacity it could acquire, build, and operate a railroad, since such authority was not forbidden (3). This doctrine, however, is not now followed in England in parliamentary corporations (4).

SECTION 2. CLASSES OF CORPORATE POWERS.

§ 108. **Corporate powers are of three classes:** (1) Incidental; (2) express; (3) implied. The incidental powers are such as are annexed tacitly, without any express words, to any corporation duly created. They include: (a) The power to have perpetual succession for the period designated in the charter or statute; (b) to have a

(2) Thomas v. Ry. Co., 101 U. S. 71.
(3) Riche v. Ashbury Ry. Co., L. R. 9 Ex. 224.
(4) Same case, reversed in the House of Lords, L. R. 7 H. L. 653.

corporate name and to contract, grant, receive, sue, and be sued therein; (c) to purchase and hold the personal and real property necessary to carry on the business for which it was formed; (d) to have and use a corporate seal; (e) to make by-laws; (f) to remove members and officers under some circumstances.

Express powers are such as are specifically enumerated in the charter or general law, and constitutionally granted therein, together with such as are lawfully inserted in the articles of incorporation. But powers not authorized by the general law cannot be acquired by placing them in the articles of incorporation.

Implied powers are such as are reasonably necessary or proper for the execution of the powers expressly granted, and not expressly or impliedly excluded. In this connection, *necessary* does not mean indispensable but does include that which is convenient and usual in carrying out the express powers. But where a corporation was formed "to manufacture cars, and to purchase, acquire, and hold such real property as may be deemed necessary for the successful prosecution of its business," such corporation had no authority to build a town for its employes, put up 2200 houses for them, construct streets, sewage, sewage farms, gas and water works, erect school houses, churches, hotels, theaters, market-houses, concert and dancing halls, and provide for carrying them on, establish and operate groceries, dry goods and other stores for furnishing their employes with supplies, at a place about 18 miles from Chicago, where land was much cheaper than in Chicago, and where it was desirable to locate their extensive shops,

and where, at the time, there were no dwellings, stores, schools, and places of amusement and subsistence sufficient for the needs and convenience of the large number of employes needed to carry on the business. On the other hand it had implied power to acquire 55 acres of vacant land upon which to dump cinders, and 25 more acres upon which to store cars, also to build larger boilers than were then needed in order to meet future needs, and in the meantime to furnish power to adjoining plants, and under the power to "sell supplies" on its palace cars, it might sell beer, wine, and whiskey, as beverages, but could not hold shares in a steel company, all the product of which was used by the car company in the construction of its cars (5).

§ 109. **Rules for construing corporate charters.** The legislative intention is to be ascertained, if possible, and given full effect; the language is to be construed neither strictly nor liberally, but according to its fair import; words are to be given their ordinary meaning, unless custom or usage has given them a different one; the whole law or charter is to be considered; but the enumeration of certain powers, by implication excludes all other unnecessary powers. When the question is one between the state and the corporation, or when the public interest is involved, a strict construction against the corporation and in favor of the state will be applied, and then, if the charter is silent about a power, it does not exist; if the language is susceptible of two meanings, that construction is to be adopted which works least harm to the state.

(5) People v. Pullman Car Co., 175 Ill. 125.

The rules of construction of the charters of corporations formed under general laws are the same as those formed under special laws (6), although some courts make an effort to apply a different rule to articles of incorporation under general laws, on the ground that they are private contracts similar to partnership association articles (7).

Section 3. Particular Powers.

§ 110. **Power to contract.** In general, in order to determine the validity of a corporate contract, three questions must be answered: (1) Did the corporation have power to make it? (2) Was it made by an authorized agent? (3) Was it made in the proper form?

The first is a question of the subject matter; the second, one of the agent's authority; and the third, one of form. The first is considered immediately following; the second belongs in the province of the law of Agency (see Volume I), the general rules of which apply to corporations as principals, as well as to individuals, or, so far as they are peculiar to corporations, are considered herein under the headings of corporate modes of action, directors, officers, etc. The third is further considered herein under the subject of the corporate seal.

§ 111. **Power to contract debts and borrow money.** A corporation may contract debts to any extent for its corporate purposes that its credit will allow, unless statutes forbid (8). Statutes frequently fix the limit as to the

(6) Oregon Ry. Co. v. Oregonian Ry. Co., 130 U. S. 1; Dempster, etc. Co. v. Downs, 126 Iowa, 80.

(7) Natl. Bk. v. Inc. Co., 41 Oh. St. 1.

(8) Barry v. Merchants' Ex., 1 Sandf. (N. Y.) 280.

amount that may be borrowed, and in such case one who has knowingly loaned money to the corporation, in excess of the limit, cannot recover the excess as against other creditors, unless the money was used in discharging existing valid debts. But one who, in good faith, loans money after the corporation has already borrowed up to the limit can recover, if he had no knowledge of the fact. It has been held that a corporation cannot borrow money for the purpose of purchasing its own shares, nor for the purpose of purchasing property not needed. Thus a savings company cannot borrow money to make an investment before it has received any deposits to be invested (9). So, too, where a national bank purchases not only the draft with the bill of lading attached, but also the goods represented by the bill, such agreement cannot be enforced against the bank (10).

§ 112. **Power to issue negotiable instruments.** Whenever it is a necessary or convenient method of conducting their proper business, corporations, through agents having the express or implied authority so to bind the corporation, have the power to issue any form of negotiable instruments; but they have no power unless expressly authorized to deal in notes or bonds. A stricter rule is applied in England than in the United States. If a corporation has power to issue a promissory note for any purpose, a bona fide holder for value, having no knowledge of want of authority of the agent or of other irregularity or that it was issued for an ultra vires purpose, will be pro-

(9) Franklin Co. v. Lewiston, etc. Co., 68 Me. 43.

(10) Leonhard & Co. v. Small, 117 Tenn. 153.

tected (11). Where a corporation was formed for encouraging athletic exercises with power to "purchase and erect suitable buildings for its accommodation," it had authority to borrow money to be used in building a club-house (12).

§ 113. **Power to issue accommodation paper.** There is no implied power to issue or indorse negotiable instruments for the mere accommodation of an outside party; but, if it is done by a corporation having authority to issue promissory notes, a bona fide purchaser, without knowledge of the fact, will be protected. Thus, where a manufacturing company, having authority to purchase property on credit and give its promissory note therefor, gave its note for the accommodation of X, without receiving any consideration therefor, and the plaintiff acquired it in due course of business before maturity, and paid full value for it, without knowledge that the corporation had received no consideration, he could enforce payment against the corporation (13).

§ 114. **Power to be surety or guarantor.** There is no such implied power. This, and the rule relating to accommodation notes, are based upon the view that neither the officers nor the majority of the shareholders have any right to give away the corporate property to the injury of other shareholders without their consent; nor can the officers or all the shareholders give away the corporate property without making provision for the payment of creditors. But since, where the reason ceases the rule

(11) Monument Natl. Bk. v. Globe Works, 101 Mass. 57.
(12) Bradbury v. Canoe Club, 153 Mass. 77.
(13) Monument Natl. Bk. v. Globe Works, 101 Mass. 57.

ceases also, and persons can give away their property if they choose, it has been held that if all the shareholders agree, and no bona fide creditor's rights are affected, the guaranty will be binding (14). There are also well-defined exceptions to the general rule; e. g., a corporation rightly holding the securities of another person or corporation has a right to dispose of them and guarantee their payment in the ordinary course of business; so also a railway company may guarantee the payment of the bonds and interest of the company whose road it is authorized to lease.

§ 115. **Power to form partnerships.** The general rule is that a corporation has no such power, unless expressly authorized; the reason being that it would necessarily give to some one outside the corporation, i. e., the other partner, a power of management over the corporation, which would be inconsistent with its duty to the state. Of course, the corporation may be expressly authorized to enter into a partnership, and in California it has been held that if the management was left entirely to the corporation it might be a partner. Where a manufacturing corporation entered into a partnership with three other similar corporations for manufacturing cotton-seed oil, and turned its plant over to the partnership for the purpose, it can repudiate the agreement, and upon failure, after demand, to allow the plaintiff to enter into possession of its own property, an action for unlawful detainer may be maintained to recover possession (15).

§ 116. **Trusts and trade combinations.** Etymologically the word trust comes from the same as *tryst, troth* and

(14) Murphy v. Land Co., 97 Fed. 723.

(15) Mallory v. Hanaur Oil Works, 86 Tenn. 598.

true. In law a trust exists whenever the legal title to property is vested in one person, called the trustee, to be held or dealt with by him, for the benefit of another, called the beneficiary. The name of the industrial institutions now designated trusts is derived from the trust of equity. Its present use originated in 1882, when the Standard Oil Trust was formed by the shareholders in several different companies transferring their shares to trustees in trust to accomplish certain business ends, converting the trust of equity into a peculiar form of business association. Since then its meaning has even become much broader, and "embraces every act, agreement, or combination of persons or capital believed to be done, made, or formed with the intent, effect, power or tendency to monopolize business, restrain or interfere with competitive trade, or to fix, influence, or increase the price of commodities." These things are not new, either in the law or in economics.

Forms assumed: A rough classification, based upon the tie that binds them together, gives the following forms: 1. Friendly agreements. 2. Pools. 3. Stock-controlling schemes. 4. Corporations.

§ 117. **Power of corporations to form trusts.** In considering this subject, two principles should be kept constantly in mind—*one,* based upon the nature of a corporation, is, that the grant of corporate power is a *franchise* granted by the state for a definite purpose, to be exercised in a way prescribed, and subject to forfeiture by the state if it is not carried out in accordance with the grant; the *second* is based upon public policy, viz., that combination

agreements of individuals, partnerships, or corporations, with the purpose and effect (with certain exceptions) of restraining trade, destroying competition, and resulting in monopoly, are unenforcible, and under some circumstances wrongful—tortious or criminal.

§ 118. **Same: Corporation must not violate its franchise.** The first principle, that a corporation must not abdicate its purpose or prescribed method of management, is well expressed in Whittenton Mills v. Upton (16), by Thomas, J., where the question involved was whether a corporation could be a member of a partnership. He said: "No member of the corporation, as such, can bind the society. In a partnership each member binds the society as a principal. If, then, this corporation may enter into partnership with an individual, there would be two principals, the legal person and the natural person, each having, within the scope of the society's business, full authority to manage its concerns, including even the disposition of its property. . . . The partner may manage and conduct the business of the corporation, and bind it by his acts. In doing so he does not act as an officer or agent of the corporation by authority received from it, but as a principal in a society in which all are equals, and each capable of binding the society by the act of its individual will." This agreement was held void. Such agreements, if valid, would have the effect, as Judge Finch says, in People v. North River Sugar Ref. Co. (17), to permit a corporation "to receive its powers and priv-

(16) 10 Gray (Mass.) 582.
(17) 121 N. Y. 582.

ileges merely to put them in pawn; and to give away to an irresponsible board (or person) its entire independence and self-control."

The above were cases of purely private business corporations, not those owing any special duty to the public. The rule applies, of course, with more reason and more strictness to *quasi-public* corporations, or those owing particular duties to the public. As stated by Justice Miller in Thomas v. West Jersey R. Co. (18), "Where a corporation, like a railroad company, has granted to it by charter a franchise intended, in large measure to be exercised for the public good, the due performance of those functions being the consideration of the public grant, any contract which disables the corporation from performing those functions, which undertakes, without the consent of the state, to transfer to others the rights and powers conferred by the charter, and to relieve the grantees of the burden which it imposes, is a violation of the contract with the state, and is void as against public policy."

From these principles, therefore, it follows that all contracts of a corporation, either private or quasi-public, to enter into combinations, whether of partnership, pool, restraint of trade, trust, lease, consolidation, sale or otherwise, the necessary effect of which is to destroy its autonomy in the performance of its duty to the state, are, or ought to be, held to be void and unenforcible, and this so, regardless of any other quality of the contract. And it is generally held so, although there are some holdings

(18) 101 U. S. 71.

to the contrary, in the case of leases and sales by purely private corporations.

While a contract by a corporation violating this principle alone is not criminal or wrongful, it is ultra vires in the true sense, and the state undoubtedly has a technical right to complain. The state, however, does not, and will not, complain of such a transaction unless the contract made, or things done under it, injuriously affect or threaten public interests; then the state may interfere by quo warranto to prevent or enjoin its consummation, either by ousting the corporation of the power usurped or annulling the charter.

§ 119. Same: Contacts in restraint of trade are void. The second principle—that contracts in restraint of trade (with certain exceptions) are void and unenforcible—has alone, no peculiar application to corporations, but applies to individuals and partnerships also; this principle together with the first one above, gives the state a power over corporations in regard to such contracts that it does not have over individuals, viz., that the state can actively and of its own accord take the life of the offending corporation for engaging in such a contract, though no punishment, aside from refusing to enforce the contract, could be meted out to an offending individual or partnership.

What contracts restraining trade are void, is a difficult matter, in the present state of the law, to determine. Judge Taft, in the Addyston Pipe case, divides contracts in restraint of trade and competition into three classes:

(a) Those in which the restraining contract is wholly

incidental and ancillary to another main or principal contract that is lawful; (b) those in which the restraining contract is the main or principal contract, to which others are only incidental, ancillary, or preliminary to this purpose; (c) those in which the restraining contract is the only contract made.

As to class (a) it was formerly held, perhaps, that all restraints upon trade were invalid. As Judge Taft says: "The objections to such restraints were mainly two. One was that by such contracts a man disabled himself from earning a livelihood with the risk of becoming a public charge, and deprived the community of the benefit of his labor. The other was that such restraints tended to give to the covenantee, the beneficiary of such restraints, a monopoly of the trade, from which he had thus excluded one competitor, and by the same means might exclude others. . . . After a time it became apparent to the people and the courts that it was in the interest of trade that certain covenants in restraint of trade should be enforced."

And for various reasons "covenants in partial restraint of trade are generally upheld as valid when they are agreements (1) by the seller of property or business not to compete with the buyer in such a way as to derogate from the value of property or business sold; (2) by a retiring partner not to compete with the firm; (3) by a partner pending the partnership not to do anything to interfere, by competition or otherwise, with the business of the firm; (4) by the buyer of property not to use the same in competition with the business retained by the seller;

and (5) by an assistant, servant or agent not to compete with his master or employer after the expiration of his time of service. Before such agreements are upheld, however, the court must find that the restraints attempted thereby are reasonably necessary to the enjoyment by the buyer of the property, good-will or interest in the partnership bought; or to the legitimate ends of the existing partnership; or to the prevention of possible injury to the business of the seller from use by the buyer of the thing sold; or to protection from the danger of loss to the employer's business caused by the unjust use on the part of the employe of the confidential knowledge acquired in such business. . . . This very statement of the rule implies that the contract must be one in which there is a main purpose, to which the covenant in restraint of trade is merely ancillary. The covenant is inserted only to protect one of the parties from the injury which, in the execution of the contract or enjoyment of its fruits, he may suffer from the unrestrained competition of the other. The main purpose of the contract suggests the measure of protection needed, and furnishes a sufficiently uniform standard by which the validity of such restraints may be judicially determined" (19).

What, however, is reasonable or unreasonable depends upon the circumstances of each case, and different courts take different views of similar circumstances, but total restraints in both space and time are generally held void; yet with improved machinery and communication,

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(19) United States v. Addyston Pipe Co., 85 Fed. 271.

what are now reasonable for protection would formerly have been held to be unreasonable.

Under class (b) when the main contract is to restrain trade, and this does it so unreasonably as to affect public interests, such main and ancillary contracts are not enforcible. Under class (c) there being no lawful purpose to forward, no rule to measure the necessity of restriction, but a purpose to avoid competition which the law favors, such contracts should be held void. Perhaps there should be added to the above classes another that we may call class (d)—public service companies or occupations—in which any restraints that prevent them from the performance of their whole duty to the public are held to be invalid. Whether contracts in undue restraint of trade are anything more than unenforcible, that is, illegal as being tortious or wrongful, so as to be the basis of a suit for damages, or a criminal prosecution, in the absence of any statute regulating the matter, is in controversy; but the weight of authority certainly is that if there is no fraud, coercion, intimidation, or something of the kind practised upon some one, there is no civil or criminal liability.

§ **120. Anti-trust acts.** Most of the states have enacted anti-trust acts, making a civil and criminal liability for creating or attempting to create a monopoly. Some of these, especially the late Michigan, Missouri and Texas acts, are peculiarly stringent.

The United States act of 1890 (26 Stat. 209) created seven different crimes relating to interstate, foreign, or territorial trade or commerce, punishable by a penalty not exceeding $5,000, or one year's imprisonment, or both,

by providing that every person (including corporations or associations) who shall make (1) a contract in restraint of such trade, or (2) engage in a combination in form of a trust or otherwise, or (3) engage in a conspiracy, in restraint of such trade, or (4) monopolize, or (5) attempt to monopolize, or (6) combine, or (7) conspire, to monopolize such trade, shall be guilty of a misdemeanor punishable as stated; and an injured party may recover damages, and the combination can be enjoined at the suit of United States attorneys.

This applies not to the making or manufacture of goods but allows an injunction against a combination of railway employes to obstruct railroad commerce. It also prevents the formation of pools and traffic combinations among railroads, the direct tendency of which is to limit competition, whether reasonable or unreasonable; also such combinations as directly affect the sale of products that are to cross state lines. While the states have generally enacted these very stringent anti-trust acts, some of the states have with a very strange inconsistency, expressly authorized one corporation to acquire, own and vote shares in other corporations, whether competing or otherwise, and have thereby practically nullified all the supposed benefits of the anti-trust legislation, and legalized in a permanent form exactly what the anti-trust acts were designed to make criminal.

§ 121. **Unincorporated trusts.** With the foregoing principles in mind, it may be helpful to describe some of the forms assumed (as above specified) more particularly. The unincorporated forms are the first three—

friendly agreements, pools, and certain stock-controlling schemes.

§ 122. **Same: Friendly agreements.** The first, *friendly agreements* are numerous, and sometimes the most efficient. The tie that binds, however, is only the personal honor and business interest of the members. This form has been very effective in the Meat Packers' Association, a mutual understanding among some six or eight large corporations, based upon the personal honor of the members, whereby (as alleged) the price of cattle and meat in all the important markets has been controlled for a number of years. It is stated on the authority of one of their number that there is a working agreement to the effect "that they will not, to their own loss and the destruction of their goodwill, send more beef to a market than it reasonably requires. . . . Further than that there is no bond between any two houses as to *output*. It is not an illegal bond, nor is it intended to effect a restriction of trade to the detriment of the people; it is for natural and necessary self-protection. For instance, one of the packing-houses calls us up by telephone and asks, 'Are you sending any extra cars anywhere today?' We reply, let us say, 'Yes; we are sending six to New York, because we learn from the reports of our agents that the market there requires such a shipment.' The packer who called us up does not ship what extra beef he may have to New York, but to some other market. . . . Another day we call him up and ask him a similar question, and similarly abide by his answer, should it be like ours. The answer is not begotten of speculation as to the amount of

beef the market will take; it is based upon fact. We could not afford to send six cars of beef to New York or anywhere else upon the chance of disposing of them. A side of beef is marketable too short a time for that." The supreme court, however, held that this friendly agreement violated the Federal anti-trust act (20).

§ 123. **Same: Pools.** The second, or *pools,* are agreements between several to divide competitive business or products, either upon basis of work to be done, or earnings from the same, in proportions agreed upon. In all other respects each party retains full control of his property. The method of enforcement is usually by a deposit of money to be forfeited in case the agreement is violated. Pools were, perhaps, invented by the railroads, and between 1858 and 1887 a large part of the competitive railroad business of the country was made more or less noncompetitive by these institutions. In regard to such pools between connecting lines of railroad, where a division of earnings is made for through traffic, if the rates established are not unreasonable, such transactions are valid; if between competing lines and for the purpose of preventing competition they are, at common law, prima facie invalid; however in England and in New Hampshire they have been held valid if the rates agreed upon were not unreasonable. The Interstate Commerce law made them illegal in 1887, and they were formally abandoned, but superseded by various rate-fixing associations. By 1897 the country was practically parceled out into the Joint

(20) Swift v. United States, 196 U. S. 375.

Traffic Association east of the Mississippi, and north of the Ohio and Potomac; the Trans-Missouri Freight Association operating from the Missouri to the Pacific. In the south there were three separate associations which acted in harmony. In 1897-8, the Trans-Missouri and the Joint Traffic Associations were held illegal by the Supreme Court of the United States, as violating the anti-trust law of 1890. The railroads shortly after drew closer together than ever under some of the forms named below.

A good illustration of the pool is the Addyston Pipe case, in which there was an association of six iron pipe manufacturing companies. A representative board was created "to whom all inquiries for pipe shall be referred, and said board shall fix the price at which said pipe shall be sold, and bids taken from the respective shops for the privilege of handling the order, and the party securing the same shall have the protection of all the other shops." When a letting was to occur, all were notified by the board as to what material was called for; it then fixed the price, say at $24 per ton for a 2,800 ton job at St. Louis; bids were asked for by this board from the six companies; the one which offered the highest bonus, $6.50 per ton, for the privilege, was awarded the contract. When the public letting at St. Louis occurred this company bid $24 per ton, and since the law required three bidders, two of the other companies bid slightly more than $24. The bonus was divided among the companies in proportion to the capacities of the various mills composing the association.

This pool was held to violate the national anti-trust act of 1890 (21).

§ 124. **Same: Stock-controlling schemes.** The third form is the *stock-controlling* form, or the *original trust* form. This was exclusively used to effect a combination among corporations. It was accomplished by the shareholders of the several corporations to be combined delivering their shares of stock, in trust, to certain persons as trustees, with power to vote the same; in return, the trustees issued trust certificates to the former shareholders. The trust certificate holders had the power to elect the trustees; and the trustees had the power, by holding the stock of the various companies, to elect the directors of each company, and could, in this way, place the management of all the companies in the hands of the same persons. The earnings from all the companies were put together, and from this sum dividends were declared to the *trust certificate* holders; the former shareholders in the constituent companies thereby participated in the profits and losses of the combination, regardless of the financial condition of the company in which they had held stock. The Sugar Refineries Co. is a good illustration. It was organized in 1887, composed of twenty refineries, created "to promote economy, reduce cost so as to keep price as low as is consistent with reasonable profit, to furnish protection against unlawful combinations of labor, to prevent lowering of standard of refined sugar." The properties combined were capitalized at $6,690,000, but the trust capital was fixed at $50,000,000. It was declared

(21) Addyston Pipe & Steel Co. v. U. S., 175 U. S. 271.

illegal in 1890 by the New York courts, because it was a monopoly, and a partnership between corporations (22). It immediately incorporated in New Jersey as the American Sugar Refining Co. and now comes under the next form.

§ 125. **Incorporated trusts: Property owning class.** The fourth is the *corporate* form wherein a corporation becomes the apparent owner, or is organized for the purpose of apparently purchasing and owning, or holding, part or all of the stock or property of the corporations to be combined. These take two general forms: 1. Property absorption. 2. Stock absorption. In the first, the old companies usually go out of existence, leaving one collossal corporation as the owner of the property. In the second, the old companies remain.

Of the *property* owning class, a good illustration is the Glucose Sugar Refining Company (23). This company was organized in New Jersey in 1897, to purchase the property of all kinds, of all the glucose factories within the "corn belt," comprised in an ellipse 950 miles long, and 700 miles wide, of which Peoria, Ill., was the geographical center. Cash or stock was to be issued in payment for the various properties. Each company knew what the purpose was. Options were given to a Chicago bank for a certain period, agreeing to convey all the property to the bank or its transferee, upon request, at a certain date. The American Glucose Co., of New Jersey, with its plant at Peoria, Ill., had given such an option, in-

(22) People v. N. R. Sugar Ref. Co., 121 N. Y. 582.

(23) Harding v. American Glucose Co., 182 Ill. 551.

cluding a promise on its part and those of its officers, not to buy, sell or manufacture glucose or its products, for a certain period, within 1,000 miles of Chicago; other companies did substantially the same; these transactions were conducted with secrecy, and were completed, when a dissenting Illinois shareholder in the American Glucose Co. complained; the conveyance was set aside, and the carrying out of the plan enjoined. Under somewhat similar circumstances in the Sugar trust case (24), and the Trenton Potteries case (25), the transaction was held not to be unlawful in the manner in which the questions were raised.

§ 126. **Same: Stock absorption class (community of interest).** The *stock absorption* plans are mainly two, according as their ostensible purpose is (1) *managing,* or (2) *holding.* The first of these subdivide into "*community of interest*" plans; "*bond-stock*" exchange methods, or "*stock-stock*" exchange methods. Of these, the "community of interest" plan is very flexible, and does not yet seem to have a well defined meaning. The general idea is that where there are two or more competing corporations, each, or the shareholders of each, acquire by interchange a considerable part of the shares of the others, so that there is a kind of "tenancy in common" of the whole of the competing properties. The legality of such plans has not yet been the subject of litigation on the ground that they, in effect, form unlawful combinations.

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(24) U. S. v. E. C. Knight Co., 156 U. S., 1.
(25) Trenton Potteries Co. v. Oliphant, 58 N. J. Eq., 507.

§ 127. **Same: Stock absorption class (bond-stock exchange).** The *bond-stock* plan is a very simple device for placing the management of one or more companies under the control of another. A Company, having power to issue bonds, offers to B Company to issue its bonds for the shares of B Company; the offer and terms of exchange are made known to the shareholders of B Company, and, if a majority accept, the shares are transferred to A Company, and its bonds issued to such shareholders; the bonds are usually secured by a deposit by A Company of the same shares with a trustee, as collateral security for the payment of the interest on the bonds; A Company, however, retains the right to vote the shares, until default is made in paying interest. Its legality, as a plan of *combination,* has not yet been tested, but the Supreme Court of the United States has said "it is not within the general powers of a corporation to purchase the stock of corporations for the purpose of controlling their management, unless permission be given them to do so" (26).

§ 128. **Same: Stock absorption class (stock-stock exchange).** The *stock-stock* plan is substantially the same as the *bond-stock* plan, except the stock of A Company is exchanged for the stock of B Company. The most conspicuous example of this method is the United States Steel Corporation, formed February 23, 1901, in New Jersey, with an authorized capital stock of $1,100,000,000, and bonds to the amount of $304,000,000 or $1,404,000,000. Its *business* powers, by its charter, included manufacturing,

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(26) De La Vergne Refrig. Co. v. German Ins. Co., 175 U. S., 40.

mining, trading, building, transporting, and obtaining and using patents; its *trust* powers, authorized it to acquire in any way any or all of the stocks, bonds and securities, or property, of companies or persons engaged in any or all of the foregoing lines of business, and hold for investment, or use, sell, or exercise, "all the rights, powers, and privileges of ownership, and to exercise all voting power thereon," and to issue its own stock or obligations, and make any contracts in order to do any of these things. It was a combination of ten of the largest concerns engaged in the iron and steel industry at the time; each of these ten was itself a large aggregation, mostly by stock ownership, of many others ranging in number from six to thirty, several of which were made up of three or four or more sub-companies. The stock and bonds of the ten constituent companies at the time of formation amounted to $911,700,000, for which there were issued altogether $1,-167,000,000. The stockholders that formerly composed the ten or more corporations have now been consolidated into shareholders of the United States Steel Corporation, and are no longer shareholders of the constituent companies; practically the sole stockholder of each of the constituent companies is the United States Steel Corporation; as such, it elects the board of directors of each corporation, and can, if it chooses, give exactly the same board to all the companies; upon the other hand, the shareholders of the United States Steel Corporation elect its directors—who, if they wish, may elect themselves directors of each of the constituent companies. The result is the same as if the former companies, or all their share-

holders, had entered into a permanent agreement to combine their competing properties by electing the same persons directors over all the companies, with power to control the management and policy of each according to the terms of the agreement. The business result is precisely the same as that of the original *trust* form. Its legality has not been attacked in the courts.

§ 129. **Same: Stock absorption class (holding company).** The holding corporation is, or may be, created in exactly the same way as the *stock-stock* plan just described. The purpose is alleged to be different, to be *investment*, rather than *management*. Its most conspicuous illustration is the Northern Securities Company, formed (as stated) to invest in, and hold as an investment, Great Northern and Northern Pacific railway shares. These railroads are competing lines for something like 1,000 miles, and the laws of the northwestern states forbade the consolidation of parallel and competing lines. The Northern Securities Company was organized in New Jersey in 1900 with $400,000,000 capital stock. It immediately issued enough of its stock at par to acquire, in exchange, more than 90 per cent of Great Northern shares at $180; likewise it issued enough of its stock at par to acquire in exchange a like per cent of Northern Pacific at $115 per share—the Union Pacific getting $80,000,000 in Northern Securities stock, and over $9,000,000 cash, for its $78,000,000 holdings of Northern Pacific; the total issue of new stock was about $122,000,000 more than the par value of the combined capital stock of the two companies. The existence of the Securities company was to be perpetual.

In deciding that the holding of this stock by this company violated the anti-trust act of 1890 the Supreme Court through Mr. Justice Harlan said (27): "The government does not contend that Congress may control the mere acquisition or the mere ownership of stock in a state corporation, engaged in interstate commerce. Nor does it contend that Congress can control the organization of state corporations, authorized by their charters to engage in interstate and international commerce. But it does contend that Congress may protect the freedom of interstate commerce by any means that are appropriate, and not prohibited by the Constitution. It does contend that no state corporation can stand in the way of the enforcement of the national will legally expressed." Also, "although the anti-trust act has no reference to the mere manufacture or production of articles or commodities within the limits of the several states, it does embrace and declare illegal every contract, combination, or conspiracy, in whatever form, of whatever nature, and whoever may be parties to it, which directly or necessarily operates in restraint of trade or commerce among the several states or with foreign nations; that combinations, even among private manufacturers or dealers, whereby interstate or international commerce is restrained, are embraced by the act; . . . that the constitutional guaranty of liberty of contract does not prevent Congress from prescribing the rule of free competition for those engaged in interstate and international commerce." The foregoing was said in reference to section 1, of the act,

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(27) Northern Securities Co. v. United States, 193 U. S. 197.

which forbids "every contract, combination, or conspiracy in restraint of trade or commerce among the several states, or with foreign nations."

§ 130. **Same: Same (continued).** The second section reads, "every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons to monopolize" such trade or commerce shall be deemed guilty of a misdemeanor, and on conviction "shall be fined $5,000, or imprisoned one year or both." In regard to this, it seems pertinent to inquire whether, if the wealth of one person was sufficient, and he had the inclination to acquire most of the stock of the competing railroads of the west, in order to prevent competition among them, and attempted to do so—would this action violate section 2? This does not yet seem to be answered by the courts. In Illinois, where corporations may be formed for any lawful purpose, it was held that corporations for purposes of this kind, which resulted in a monopoly of the whiskey business of the country and of the gas business of Chicago, were illegal and void, and could be dissolved by the state, although apparently there was perfect compliance with the provisions of the law (28). New Jersey on the other hand, holds that courts have no authority to declare such a corporation illegal, so long as the state legislature has not expressly made them illegal (29). The Whiskey trust has passed through all possible forms from a *pool* in 1882, to an *ordinary trust* in 1887; a *corporation* trust under Illinois law in 1890, held illegal by

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(28) Distilling Co. v. People, 156 Ill. 448; People v. Gas Trust, 130 Ill. 268.

(29) Trenton Potteries Co. v. Oliphant, 58 N. J. Eq. 507.

the supreme court of Illinois in 1894; a New Jersey *managing corporation* in 1899, formed of four others, after the Illinois decision; and now finally, as formed in 1902, it is a New Jersey Distilleries Securities Corporation, controlling (or trying to) all the rest.

§ 131. **Power to consolidate.** Consolidation is a merger, union, or amalgamation, by which the stock of two or more corporations is made one, their property and franchises combined into one, their names merged, and their powers combined, so that practically one new corporation results. Consent of the state and consent of the shareholders are essential to any consolidation. By the weight of authority, under a reserved power to alter or amend the charter, the majority of members may consent to a consolidation against the wishes of the minority; if the state has not reserved the power to amend, unanimous consent of members is essential. By consolidation the old companies are usually dissolved, their property becomes that of the new company, but their liabilities continue against the old companies, although they are usually enforcible against the new company; lands vest by virtue of the consolidation in the new company without further conveyance; and generally contract rights of the old companies pass to the new, and it must perform the contract duties of the old; the new company is liable for the debts of the old companies to the extent of the property received, and, if expressly assumed, to their full extent (30); they are also usually held liable for the torts of the old

(30) Compton v. Ry. Co., 45 Oh. St. 592, 167 U. S. 1. Compare: Wabash, St. L. etc. Ry. Co. v. Ham, 114 U. S. 587.

companies. The foregoing matters are however, usually regulated, either in the agreement of consolidation, or by the provisions of the statute authorizing them. In interstate consolidations, the new company exists in each state with the powers, rights, and franchises that the constituent company in that state had, but not those that belong to the companies created in another state. Thus two companies were incorporated, one in Illinois and one in Missouri, to build a bridge across the Mississippi river at the same place; afterward they were consolidated, by authority of the laws of each state, with a capital stock equal to the sum of the stocks of the separate companies. Held, Illinois could tax the new company on all its capital stock, since it was a separate company in Illinois (31).

§ 132. **Power to acquire and hold real property.** At common law it has been said a corporation had this power to an unlimited extent. But in this country it is generally held that corporations have the right to purchase and hold only such as is necessary or convenient to carry out their legitimate purposes. If a conveyance of real estate to the corporation is executed, none but the state can afterwards complain; and it can only in a quo warranto proceeding to forfeit the corporate charter, unless some statute authorizes the conveyance to be set aside or the land to be escheated to the state (32). If the conveyance is not completed, an interested party may object in any suit by the corporation to perfect its title; and a court of equity will not decree a specific performance of a contract

(31) Quincy Ry. Bridge Co. v. Adams Co., 88 Ill. 615.
(32) Com. v. N. Y. etc. Ry. Co., 132 Pa. St. 591.

to convey land which a corporation has no authority to hold. A corporation may take any estate in land except an estate in joint tenancy, or such as dower, curtesy, or tenancy in tail. A grant of a freehold, without words of inheritance or succession, will pass a fee to a corporation aggregate, even if the corporate life is limited, but, in the case of a corporation sole, the word "successors" should be used to carry a fee. Thus, where land was granted to a railroad company, and its successors, the company took a fee, though the corporate life was limited to fifty years, and where it granted the land to another party before the coroprate life expired, the grantee took a fee (33); so also upon the expiration of the corporate life, under the modern rule, the land would become a part of the assets of the corporation, and continue an estate in fee.

§ 133. **Power to take by devise.** Corporations were expressly excepted in the English statute of wills of 1543, and consequently lands could not be devised to them. This was however a limitation on the power to devise to a corporation, rather than on the power of a corporation to take and hold land, and was placed in the statute of wills as an exception, in order to prevent the repeal of existing statutes of mortmain forbidding corporations from taking and holding land, unless they had a license from the king permitting them to do so. In this country (with the partial exception of Pennsylvania), mortmain statutes designed to preserve feudal incidents to lords upon the death of their vassals are not in force. In the absence of a special statute to the contrary, corporations are capable

(33) Nicoll v. Ry. Co., 12 N. Y. 121.

of taking a devise of land for any purpose necessary in carrying on their business (34). In some of the states there is a limit placed upon the amount which may be devised to them; in New York a devise in excess of this limit is void as to the excess, and the next of kin or residuary legatee or heirs may claim such excess (35); the general weight of authority, however, holds that only the state can complain, as in other cases (36). A distinction is to be drawn between limitations in a corporate charter and in statutes of wills; the former follows the corporation wherever it may be, at home or abroad, whereas the statute of wills operates only in the state enacting it. Thus, where the New York statute of wills forbids the devise of land to a corporation, a New York corporation may take land in Connecticut, under a will made in New York by a resident of New York, the Connecticut law of wills having no limitations in it, and the right to devise land depending on the law of the state where the land lies.

§ 134. **Power to acquire personal property.** The general rule is that such personal property, but such only, both as to kind and amount, as is reasonably necessary for the corporate purposes, may be lawfully acquired; but there is no limit as to the amount of personal property that may be acquired through the profits of carrying on the corporate business. For example where a packet company was organized with power to own and control vessels for transporting freight and passengers on the Mis-

(34) For the history of these matters, see McCartee v. Orphan Asylum, 9 Cow. (N. Y.) 437.

(35) In re McGraws' Estate, 111 N. Y. 66.

(36) Farrington v. Putnam, 90 Me. 405.

sissippi river, and to own warehouses necessary for storing and forwarding property, and to do any and all business incidental to transportation of persons and property, it had no authority to purchase 4,000 bushels of wheat to be transported, and could not maintain an action against the party for failing to deliver the wheat as agreed, although payment of $1,000 had been made thereon; the $1,000 paid could be recovered in an action for money had and received (36a).

§ 135. **Power to acquire its own shares.** In the United States, perhaps the weight of authority allows a corporation to purchase its own shares, so long as the security of creditors is not impaired thereby. There is no doubt that it may do so in order to prevent loss to the company. In England and in many of the states, however, the rule is otherwise. And in those states which allow corporations to purchase their own shares, it is said they ought not to be allowed to speculate in them, and such transaction must be not only in entire good faith, but the exchange must be of equal value, free from fraud, actual or constructive, made when the corporation is not insolvent, nor in the process of dissolution, and be neither injurious to creditors, nor to the advantage of a few favored stockholders and to the injury of the others (37). The purchase of its own shares is not a reduction of the capital, if the purchase is made from profits; and the shares, even if purchased from capital, may be sold again to replace the amount paid. While the corporation owns its own shares, they are dormant and not to be voted by it.

(36a) Northwestern Packet Co. v. Shaw, 37 Wis. 655.

(37) Prince v. Pine Mt. Co. (Ky.), 32 S. W. 267.

§ 136. **Power to acquire stock in other corporations.** The general rule in the United States is that one business corporation has no general or implied authority to acquire or hold stock in another such corporation, organized either for a similar or different purpose, as an investment, for speculation, or for the purpose of controlling or managing such corporation (38). There are some cases to the contrary, as is the English doctrine. When it is necessary to prevent loss or to secure the payment of a debt, such stock may be taken. It is held a parent company may secure the stock of a branch company, and it is usual to say that authority to consolidate implies a power to purchase the stock of a company with which the consolidation might be made. Several states have by statute authorized corporations to acquire, own, hold, and vote shares in other corporations, and it is sometimes said that charitable, educational, insurance, and savings bank companies have an implied power to invest their funds in the stocks and bonds of other corporations. Where one company holds stock in another, without authority, it may collect dividends, but cannot vote, and a national bank is not liable for any statutory liability on such stock.

§ 137. **Power to alienate property.** Corporations are held to have the power to alienate their property in the ordinary course of business to any extent, if creditors, or dissenting shareholders, or the public, are not injuriously affected; if the corporation is a failing one the majority of members may dispose of all its property for the pur-

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(38) People v. Gas Trust, 130 Ill. 268.

pose of closing out its business and paying creditors, against the consent of the minority; but not otherwise. Such property as is charged with a public trust, or which is essential to the performance of the duties the corporation owes to the public, cannot be sold so as to prevent the performance of such duties. The corporate franchise cannot be disposed of without special authority, and, when that is given, the theory is that a sale of it is in effect a surrender to the state and a regranting of it by the state to the purchaser, who takes it subject to the provisions of the law as they exist at the time of the purchase (39). The power to sell includes the power to mortgage.

§ 138. **Power to act in a personal relation.** A corporation may take property that it has authority to own, in trust, and administer the trust according to its terms. In some states it is held that a corporation may be an executor, administrator, or guardian, and they are frequently authorized to be such by statute. They may also be an agent or attorney in fact.

§ 139. **Right to sue.** At common law a corporation has the right to sue anywhere that it can find the defendant and serve him with process. States may exclude foreign corporations from suing in the state courts, except as to interstate or foreign commerce, but no state can exclude a foreign corporation from suing in the Federal courts; Federal corporations also have the right to sue in the Federal courts.

§ 140. **Suits against corporations.** For purposes of suit in the United States courts, either by or against the

(39) State v. Sherman, 22 O. St. 411.

corporation of another state, it is conclusively presumed to be a citizen of the state (40), and an inhabitant of the district, in which it is incorporated (41). Alien corporations, such as are formed under foreign governments, may be sued in the United States courts in the district where they may be found doing business. Corporations of other states may be sued in the state courts of any state where they may be found doing business, if proper service of process can be made upon them; and it has been held that a corporation is doing business in a state when a traveling salesman is within the state taking orders for goods, and service of process may be made upon him in suits arising out of the business done with him. It is usual to say that the corporation must be engaged in business in the state, and that the agent must stand in some representative character to the company in order to make the service of process valid, and a personal judgment against it effective (42). Service upon an officer temporarily within the state is not generally sufficient.

§ 141. **Pleading.** The courts are in conflict as to the necessity of alleging corporate existence; one line of authorities holds that the plaintiff corporation must always allege itself to be such; another line holds exactly the contrary. One line of authorities holds that, in a suit against a corporation, the plaintiff must allege that the defendant is a corporation; and others hold just the reverse. So, too, one line of authorities holds that pleading the general

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(40) St. Louis, etc. Co. v. James, 161 U. S. 545.

(41) Shaw v. Quincy Mining Co., 145 U. S. 444.

(42) St. Clair v. Cox, 106 U. S. 350.

issue or a general denial raises the question of corporate existence; others hold the reverse.

§ 142. **Right to have and use a seal.** At common law it was said a corporation could contract only under its corporate seal (43); the rule is now otherwise, and the corporation is not generally required to contract under its corporate seal in any other case than an individual would be required to do so (44); signing is now generally of more importance than sealing, although at common law sealing without signing was sufficient. Any device adopted by the corporation as a seal will be sufficient; if the seal alone is present it must be proved to be a corporate seal; if a contract is shown to have been executed by the proper officer with authority, any seal will be presumed to be the corporate seal. The presence of the corporate seal is generally held to be prima facie evidence of the agent's authority and the regularity of the corporation's actions, but this is also denied; it is said to be evidence of a valid and sufficient consideration, but it does not exclude inquiry into those matters. If present upon a negotiable instrument it does not make it non-negotiable (45).

§ 143. **Power to make by-laws.** A by-law is a regulation made in regard to the relation of shareholders and officers to the corporation, or prescribing the functions of officers, times and places of meeting, etc. (46). The power to make them is incidental to corporate existence, and resides in the shareholders, unless otherwise provided.

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(43) Horne v. Ivy, 1 Mod. 18.

(44) Muscatine Water Co. v. Lumber Co., 85 Ia. 112.

(45) Chase Natl. Bk. v. Faurot, 141 N. Y. 532.

(46) State v. Overton, 24 N. J. L. 435.

This authority may be conferred upon directors. In the absence of special statutory authority, there is no power to provide by by-laws for forfeiture of shares for non-payment, or to prevent the transfer of shares, or to create a lien upon shares that will be effective against transferees without notice, or for the expulsion of members of a corporation having a capital stock.

By-laws must be reasonable, conform to the charter, to statutes, and to the common law; must operate uniformly, and not be in restraint of trade. They cannot modify vested rights, change terms as to dividends, increase or decrease liability of shareholders, or enlarge corporate powers. Members and officers, but not outside parties, are presumed to have notice of their provisions. For example, where a by-law provided that "the members pledge themselves in their individual as well as collective capacity to be responsible for all moneys loaned" to the corporation, and plaintiff loaned money to the corporation, but had no knowledge of such a by-law until after the loan was made, he could not hold shareholders individually liable (47).

SECTION 4. DOCTRINE OF ULTRA VIRES ACTS.

§ 144. **Meaning of term.** Ultra vires literally means "beyond the powers;" in its application to corporation law it means beyond the authority of the corporation—the corporation may have the power but not the rightful authority to do the act; and, since there is no authority to do the act, there is no authority to ratify it, even if all the shareholders should consent. There are various

(47) Flint v. Pierce, 99 Mass. 68.

theories as to the effect of an ultra vires act; some authorities say such acts are void, either because of a legal incapacity to do the act (48), or because it is against public policy (49). Others say they are enforceable whenever it would work injustice not to enforce them (50). The reasons for the first theory are: (1) The interest of the public that corporations shall not transcend the powers granted; (2) the interest of the shareholders that the capital shall not be subjected to risks of enterprises not contemplated by the charter; and, (3) the obligation of everyone contracting with the corporation to take notice of the legal limits of its powers. The reason for the second theory is that no one should be allowed to retain the benefits of the exercise of a power claimed, without fully discharging the obligation arising thereon. The doctrine is now confined almost exclusively to contracts, and is not applied in the law of torts.

§ 145. **As to executed contracts.** Ultra vires contracts, wholly executed by both parties, will not be disturbed on complaint of either; the court will generally leave the parties as it finds them; yet not always so, for, under some circumstances, it may help one party to secure payment or possession of property parted with under an ultra vires agreement. Thus, where a person granted land by a deed delivered to a corporation having no authority to take the land, but which did, nevertheless, and paid in full for it, the grantor could not repudiate his deed

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(48) Central Trans. Co. v. Palace Car Co., 139 U. S. 24.

(49) Selden, J., in Bissell v. Ry. Co., 22 N. Y. 259.

(50) Comstock, J., in the same case.

and recover the land (51). So where a corporation, without authority to acquire or deal in lands, deeded land to the defendant, who paid one-third of the purchase price and refused to pay the balance, the court enforced full payment (52); so, where a corporation without authority to form a partnership, did so, and placed its real property in the partnership, the corporation could withdraw and, after demand and refusal to deliver, could bring suit for unlawful detention of its property (53); but a court of equity will not annul an executed ultra vires lease upon application of the lessor (54).

§ 146. **Executory contracts.** Ultra vires contracts wholly executory, that is, not performed by either party, may be repudiated by either party to the contract; in fact it is usually said to be the duty of either party to withdraw from them, and, when he does, no action for damages will lie and a court will not decree specific performance. Thus where J agreed with a corporation (which had no authority to subscribe for bonds of another company) to buy and sell such bonds on the joint account of himself and the corporation, and he did so, the corporation could not recover from J half the profits made by the purchase and sale (55). On the other hand, where a party, together with a corporation having no such authority, became surety for a third party, the first party could not recover from the corporation one-half of the

(51) Long v. Georgia Ry. Co., 91 Ala. 519.
(52) Fayette Land Co. v. L. & N. R. Co., 93 Va. 274.
(53) Mallory v. Hanaur Oil Works, 86 Tenn. 598.
(54) St. Louis, etc. Ry. Co. v. Terre Haute & I. Co., 145 U. S. 393.
(55) Nassau Bk. v. Jones, 95 N. Y. 115.

whole sum necessary to discharge the surety obligation, though it was fully paid by him (56).

§ 147. **Partially executed contracts.** There are two general views as to the legal effect of such a contract; the rule in England, in the Supreme Court of the United States, and in several of the states, is that such a contract is absolutely void as a contract, and no action in any form can be maintained upon it (57). However, if the person who has performed his part has parted with anything of value, that may be recovered from the other party in any form of action proper for such purpose. The other view, held by a number of the state courts, is that the person who has not yet performed his part, but who accepts or retains any of the benefits received from the other party, is thereby estopped from denying the validity of the contract, and consequently it is enforceable according to its terms by the other party (58). Thus, where a corporation loans money without authority, taking a note therefor, it cannot maintain an action on the note by one view, and can by the other. So, too, where an insurance company, having authority only to insure against accidents in travelling, insured the plaintiff against accidents caused otherwise, although he had paid his premium and received his policy, he could not recover under his policy, by one view (59); although by the other and more equitable, but less logical view, where a party was insured against destruction of his crops by hail, by a company

(56) Lucas v. White Line, etc. Co., 70 Ia. 541.
(57) Central Trans. Co. v. Pullman Co., 139 U. S. 24.
(58) Bath Gas L. Co. v. Claffy, 151 N. Y. 24.
(59) Miller v. Ins. Co., 92 Tenn. 167.

authorized only to insure against destruction by fire or lightning, he can recover on the policy (60).

§ 148. Who may complain of ultra vires contracts? (1) The state may if the public interest is injuriously affected; (2) the parties may, except as limited in the preceding subsections; (3) shareholders may enjoin the completion of an executory ultra vires contract, and, in some cases, if they act promptly, may have an executed ultra vires contract set aside (61); (4) creditors cannot usually complain, but, where the ultra vires contract would, if performed, make the corporation insolvent, it has been held that the creditor can enjoin the performance or have it set aside (62). This matter is further considered below. Outside parties, although they may be in some way affected by the ultra vires contract, cannot enjoin its performance.

SECTION 5. LIABILITY FOR TORTS AND CRIMES.

§ 149. Torts. Corporations are liable for the torts of its officers, agents, and servants, substantially as the master is liable for the torts of his servant while engaged in the master's business; and, in this connection, the managers of the corporation are practically the corporation, the whole of the corporate duties being vested in them. Corporations have been held liable for damages from assault and battery, false imprisonment, libel, malicious prosecution (63), fraud and deceit, conspiracy, trespass,

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(60) Denver F. Ins. Co. v. McClelland, 9 Colo. 11.

(61) Elyton Land Co. v. Dowdell, 113 Ala. 177.

(62) Lothrop v. Stedman, 42 Conn. 583; Cole v. Iron Co., 133 N. Y. 164.

(63) Goodspeed v. Haddam Bank, 22 Conn. 530.

nuisance, negligence, etc. It has been said they are not liable for slander, because slander cannot be committed by an agent, but this does not seem right, and recent cases repudiate this view (64). By the weight of authority, a corporation is liable for torts arising in a business that is ultra vires (65). They are liable for exemplary damages, as masters are for torts of their servants. In general, see Agency, in Volume I of this work.

An exception is made in the case of charitable corporations, such as hospitals, etc., that receive no compensation for their services; the funds of such institutions are not taken to pay damages for torts committed by their agents, such agents alone being held; some recent cases, however, take a different view.

§ 150. **Crimes.** Corporations are held liable for crimes arising out of non-feasance or misfeasance, and also for criminal libel. There seems to be no good reason why they might not be held criminally liable for many other offenses, even for felonies of the higher grade, except that the criminal laws are strictly construed, and do not usually provide penalties that could be applied to them. There is a tendency to hold them liable for such crimes as may be punished by fines (66).

Corporations are liable for contempt of court as individuals are, and may be punished therefor by fines imposed upon them (67).

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(64) Sugar Mfg. Co. v. Taylor, 130 Ala. 574.
(65) Nims v. Boys' School, 160 Mass. 177.
(66) People v. Rochester Ry., etc. Co., 195 N. Y. 102.
(67) Telegraph Newspaper Co. v. Comm., 172 Mass. 294.

CHAPTER V.

THE CORPORATION AND THE STATE.

§ 151. **General methods of control.** (1) *By the courts*: The state, by permitting actions at law and suits in equity, exercises general control over corporations as over other persons. But the state also exercises, by visitation through the courts or commissions, special control over corporations under certain circumstances. (2) *By legislative bodies*: Certain powers, such as the general regulation of all persons, whether natural or artificial, within the state, inhere in Congress and the state legislatures; other special legislative powers are frequently reserved to the state, when the corporation is created. The legislative power of the state is limited by constitutional provisions.

§ 152. **Limitations of Federal Constitution upon legislative control.** (1) *Upon Congress*: No person shall be deprived of life, liberty, or property without due process of law; nor shall private property be taken for public use without just compensation; direct taxes shall be apportioned among the states according to population; bills of attainder and ex post facto laws shall not be passed; taxes or duties shall not be laid upon articles exported

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(1) State v. Milwaukee Chamber of Commerce, 47 Wis. 670; People v. Dashaway Assn., 84 Cal. 114.

from any state; preferences shall not be given to the ports of one state over those of another, and vessels shall not be obliged to enter, clear, or pay duties in another. Most of the foregoing provisions protect corporations practically the same as individuals. (2) *Upon state legislatures*: They shall not pass bills of attainder, ex post facto laws, or laws impairing the obligation of contracts; lay imposts or duties on imports or exports, or any duty of tonnage; nor abridge the privileges or immunities of citizens of the United States; nor deprive any person of life, liberty, or property without due process of law; nor deny to any person within the jurisdiction of the state the equal protection of the laws; provisions similar to the last three are usually found in state constitutions also. They operate to protect corporations, very largely as individuals are protected, except corporations of one state are not entitled to the privileges and immunities of the citizens of the several states.

Section 1. The State and Its Own Corporations.

§ 153. **Control by the courts.** There are five special methods available to the courts, usually authorized by statute, but existing at common law. These are: (1): Quo warranto, or an information in the nature of quo warranto, as it is now called. 2. Scire facias. 3. Mandamus. 4. Injunction. 5. Indictment. While it is usual for the attorney-general to start these proceedings (except injunction), the court itself, in order to protect the public interest in a proper case has authority to direct some one to bring them (2); and, by statute in many

(2) State v. Cunningham, 83 Wis. 170.

states, the proceedings may be on the relation of any individual.

The writ of *quo warranto* is issued to bring a corporation before the court to show "by what authority" it claims or exercises corporate franchises, and is applicable to cases where there never has been a right, as well as where there has been a cause of forfeiture, by neglect or abuse; the same end is now accomplished in a similar way by an information in the nature of quo warranto; the judgment is an ouster and seizure of the franchises. *Scire facias* is used generally where there is a legal corporation which has abused its authority, and it is called upon to "make known" why it has done so; the judgment is the same as in quo warranto. *Mandamus* is a writ issued to compel the performance of a definite corporate duty fixed by statute, charter provision, or by the common law. *Injunction* is a writ issued by a court of equity to prevent the doing of some threatened act. An *indictment* is a criminal proceeding to punish a corporation for creating a public nuisance, or other misdemeanor.

§ 154. **Causes of forfeiture.** Any abuse, misuse, or non-use, of corporate franchises to the injury of the public is cause of forfeiture by the state in quo warranto or scire facias; such as engaging in unlawful combinations; in illegal insurance, or banking; for fraudulent organizations; wilful or negligent non-user, etc. Also for usurpation of any public franchise; or imperfect or insufficient organization, or exercising corporate powers after expiration of charter; also for illegal intrusion into a corporate office.

§ 155. **Statutes of limitation and waiver.** There is an English rule that after six years have elapsed, subsequent to the cause of forfeiture, the courts will not entertain a quo warranto, upon the relation of a private individual; but no such rule applies to the state or the king—statutes of limitation do not run against the state, unless the state is expressly named. Many of the states have, however, provided that the states shall not bring quo warranto proceedings after a certain time, varying from 8 to 21 years. The legislative body may, after a cause of forfeiture has occurred, waive the state's right to complain, and the failure of the attorney-general to act has a similar, but not the same, effect; a waiver by the legislature pardons the offense, and the state cannot afterwards forfeit the charter for that offense; but the failure of the attorney-general does not pardon the offense—merely postpones action.

§ 156. **Mandamus.** This is a prerogative writ to compel the performance of a duty. Whenever a *specific* and determined legal duty is imposed upon a private corporation, expressly or impliedly, by statute, charter, or common law, and there is no other adequate remedy for its enforcement, mandamus will lie in a suit in behalf of the state to enforce the public duty, or, in case of a private right, on behalf of the person to whom the duty is due; but not to enforce a mere optional corporate privilege, or to control discretion. It has been used to reinstate a member, compel the callings of meetings, or the inspection of books, or a transfer of shares; or to compel public service companies, as water, gas, telegraph, railroad, etc.,

to perform their duties to the public, or to individuals. For example, where a railroad company, with the power of eminent domain, has constructed and operated its road, it will be compelled by mandamus to accept and transport freight, notwithstanding there is a strike of employees for higher wages, there being no violent interference by the employees (3). So, where a street railway company refused to transfer a passenger from one part of the road to another, without the payment of an extra fare, where the terms of the grant required such transfer, the passenger could compel the company by mandamus to transfer him (4). But where a corporation had merely the privilege and not the duty of placing its car tracks in certain streets, it would not be compelled to place or keep them there (5).

§ 157. **Control by courts of equity.** These courts have no general jurisdiction to dissolve corporations, though it has been held that where dissolution was necessary to prevent the continuance of a fraud, in a suit of which the court has jurisdiction because of the fraud, it could go to the extent of decreeing dissolution; such power, under similar circumstances, is frequently conferred on such courts by statute. Neither do courts of equity usually have power to enjoin ultra vires corporate acts, without other grounds of jurisdiction. An injunction may be granted upon the application of the state, whenever a corporation is abusing the power given it for a public purpose, or acting adversely to the public, or creating a

(3) People v. N. Y. Central Ry. Co., 28 Hun (N. Y.) 543.
(4) Richmond Ry. Co. v. Brown, 97 Va. 25.
(5) San Antonio St. Ry. Co. v. State, 90 Tex. 520.

nuisance, or threatening to do these; or to prevent a dissipation of the funds of a public charitable trust, when the beneficiaries are so numerous and indefinite that the trust can be preserved only through the public authority. A shareholder may enjoin the acceptance of fundamental changes, the diversion of the funds, or the completion of executory ultra vires contracts. Where one member of a corporation obtains control of it, and fraudulently appropriates all its income by an excessive salary paid to himself as president, and by excessive rent paid to himself for property leased to the corporation, a court of equity may decree dissolution to prevent the continuance of the fraud (6). So, too, the state may have an injunction to prevent the giving of a prize fight exhibition by an incorporated athletic club (7). But the state cannot, by an injunction in a court of equity, prevent an ice company from manufacturing linseed oil. The remedy is quo warranto in a court of law (8).

§ 158. **Indictment.** This has been sufficiently considered above (§ 150), in discussing corporate liability for crimes. At common law corporations were subject to indictment for public nuisance, and are now generally for such, and for violation of anti-trust, safety appliance, and pure-food laws, giving rebates, and matters of a similar kind.

§ 159. **Control by private visitor.** In the case of charitable corporations. the person who endowed the charity

(6) Miner v. Belle Isle Ice Co., 93 Mich. 118.
(7) Columbian Athletic Club v. State, 143 Ind. 98.
(8) Atty.-Gen. v. Tudor Ice Co., 104 Mass. 239.

had, at common law, the right to appoint a visitor to see if the funds were applied according to the terms of the gift; if he did not appoint any, the right to do this resulted to himself and his heirs; but, since we have abolished the English primogeniture rules of descent, and all of a man's children become his heirs, such method of visitation is impracticable, though, if not waived, the legal right yet remains. Statutes, however, usually provide other methods, and such visitorial rights, unless otherwise provided, are presumed to be vested in the corporate trustees (10).

§ 160. **Control by public visitor.** In most of the states there are railroad, insurance, and other commissioners, whose duty it is to inquire into and report upon the condition of various kinds of corporations; these are provided for the protection of the public, and have been held to be valid methods of the state in supervising such corporations as are likely to become injurious if not looked after in some such way (11).

§ 161. **Control by the legislature.** This is either: (1) Ordinary, or (2) extraordinary. In the exercise of the ordinary legislative powers corporations are subject to the power of eminent domain, the police power, and the taxing power. In the exercise of extraordinary powers, under some circumstances, corporate charters may be (a) repealed, or (b) amended.

§ 162. **Power of eminent domain.** Corporations, like natural persons, are subject to the power of the state to

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(10) Trustees of Dartmouth College v. Woodward, 4 Wheat. 518.

(11) Weld v. Gas Co., 197 Mass. 556.

take any of their property or their franchises for public purposes upon making due compensation. The general rule, however, is that property already devoted to a public use cannot be taken for another public use without express authority; and it is sometimes said that the new use must be different from the old use—that is, one railroad company could not be authorized to take the whole line of another railroad company to be operated in the same way; horse street-railways however have been taken by electric companies, and toll-roads have been taken by the state and turned into free roads. And so, where a bridge company was incorporated with the exclusive right to build a toll bridge over a river and take the tolls for its use, such bridge and the right to take tolls may be taken under the power of eminent domain, and upon payment therefor may be converted into a free bridge (12).

§ 163. **Police power.** Corporations are subject to the police power of the state, the same as individuals; although they may be chartered for the express purpose of carrying on a lottery or manufacturing liquor, subsequent legislation may forbid such acts, without impairing the contract, for the reason that no one can obtain a vested right in any business that is dangerous to the public health, the public morals, or the public safety. The state cannot surrender or barter away its control over these subjects. Under this power, also, the rates to be charged by a public service company (within the limit that forbids depriving them of their property without due process of law) may be fixed or regulated; so reports from in-

(12) West River Bridge Co. v. Dix, 6 How. 507.

surance, trust, building and loan, bank, and other like companies, may be required for the protection of the public. The general limits to this power are that, in case of lawful businesses, property cannot be confiscated by the state, vested rights divested, nor the performance of national functions interfered with, by the state legislature. For example, where a lottery company paid five thousand dollars to the state, and agreed to pay one thousand dollars as an annual tax for the privilege of carrying on a lottery, for twenty-five years, the state could revoke this privilege at any time, without specifically reserving the right to do so, and without repayment to the corporation of any money received (13). Or, a state can pass a law repealing an existing license law, and forbid the further manufacture of liquors and sale of liquors made prior to the prohibitory law, without "depriving any one of his property without due process of law" (14).

§ 164. **Taxation.** The state's power to tax corporations is the same as in the case of individuals. The corporate elements of taxation are (15): (1) the primary franchise; (2) the secondary franchises; (3) the property, real or personal, tangible or intangible; (4) the capital stock authorized, subscribed, or paid in; (5) earnings, gross or net, or profits; (6) the shares of stock owned by shareholders. It is possible that all of these might be taxed at one time without being illegal, though it would be what is in some sense double, or treble, or quadruple

(13) Stone v. Mississippi, 101 U. S. 814.
(14) Mugler v. Kansas, 123 U. S. 623.
(15) Farrington v. Tennessee, 95 U. S. 679.

taxation. The matter is statutory, and there is but little uniformity in the statutes or the decisions of the various states upon the subject of corporate taxation.

§ 165. Taxation of franchises. It is not usual to separate the primary franchise—the right to be a corporation and exercise corporate powers—from the secondary franchises, such as the right to occupy the streets by a street railway, for the purpose of taxation. Some courts seem to think that, since the state charges a very small fee or none at all for incorporation, the primary franchise has no value (16); the proper view, however, seems to be that its value is whatever it adds to the convenience, efficacy, and safety of conducting the business by the corporate form of organization over other forms; in other words, what would those who have it give for it rather than do without it (17). Its value is difficult to estimate, and many rules for ascertaining its value have been suggested. Without attempting to separate the primary and secondary franchises, these two methods of valuation have been approved: (1) Find the market value of all the shares and bonds of the corporation; from this subtract the assessed value of all the real and personal property, and the balance will be the value of the franchise. (2) Ascertain the total net earnings (usually the average for a period of years); capitalize these at the average rate of interest upon short loans; from the total amount so found, subtract the assessed value of the real and personal property, and the balance represents the value of the fran-

(16) Detroit Citizens Ry. v. Common Council, 125 Mich. 673.

(17) Bank of California v. San Francisco, 142 Cal. 276.

chise; both of these in fact are based upon the earning capacity of the capital of the corporation, and is the business man's estimate of its value (18).

The situs of the secondary franchise, such as operating a street railroad, for purposes of taxation, is where the line is operated; the same is true as to a railroad corporation. The situs of the primary franchise is usually considered as being at the principal office of the corporation; it undoubtedly can be, however, considered as having a situs wherever the corporation does business, in proportion to the business done; and it is usually so considered when business is done in two or more states.

§ 166. **Taxation of property.** The corporate property of whatever kind is subject to taxation, the same as that of individuals. There is a tendency now to consider the property as a unit devoted to a special purpose, and to have all of it assessed by one state board instead of by local assessors. After it is assessed by the state board, the apportionment may be, and frequently is, made among the various local subdivisions of the state, in proportion to the business done in these districts, or mileage therein, in the case of railroad or telegraph companies, etc. In administering taxing laws it is not usual to consider that the term "property, real and personal," includes "franchises" unless expressly so provided, yet the legislature may so direct, and provide a method of valuation (19). And where the statute required all property to be taxed at its true value in money, and directed the assessors, in

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(18) Spring Valley W. W. v. Schottler, 62 Cal. 69.
(19) People v. State Board, 174 N. Y. 417.

determining the value of express, telegraph, and telephone companies, "to be guided by the value of said property as determined by the value of their entire capital stock," such proportion of the total value of the capital stock of an express company could be considered as located in Ohio, as the value of the tangible property in Ohio bore to the total value of all the tangible property of the company, wherever located (20). Patents and copyrights are not the subjects of state taxation, but good will may be taxed where the corporation does business. Patented articles and copyrighted books, etc., are taxable as property. The states cannot tax the franchises of a national corporation without the consent of Congress, nor can they tax any national government agency.

§ 167. **Taxation of gross or net earnings.** These may be the basis of taxation by the state in the case of corporations not engaged in interstate commerce, or upon such earnings as are not derived from such commerce. But the states cannot directly tax corporations upon the monthly or yearly earnings derived from such commerce, though of course they can tax them upon any money or property found actually in their possession on the assessment day, from whatever source derived; this is a tax on property and not earnings. It has been held also that corporations may be taxed upon their capital stock, and the tax rate may be graded according to the gross or net earnings, or dividends, whether they are partly derived from interstate commerce or not; this is on the theory that the

(20) Adams Ex. Co. v. Ohio, 165 U. S. 194, 166 U. S. 185.

tax is on the property and not on the earnings for any period (21).

§ 168. **Taxation of shares.** These are taxable, although the property or capital stock is taxed, and whether this is at its actual or at its face value. In several states this is held not to be double taxation (22), though others hold otherwise. The situs of shares for the purposes of taxation is usually the domicile of the owner, but the state may make their situs to be that of the domicile of the corporation, and tax them there, even though their owner lives in another state and is taxed there on the same shares (23). It has been held that alien owners may be taxed higher than resident owners, but this is not the case if the owner is a citizen of the United States residing in another state.

§ 169. **National taxation of state corporations.** The national government has the same power to tax state corporations and their property, as it has individuals and their property. The Federal taxing power can be used for the purpose of regulation as well as raising revenue (24).

§ 170. **Repeal and forfeiture.** These have already been mentioned under dissolution. If there is no power reserved to the state legislature, it cannot repeal any corporate charter, although Parliament and possibly Congress may do so; if the power to repeal is reserved without qualification, it may be exercised at any time, with or

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(21) Maine v. Grand Trunk Ry. Co., 142 U. S. 217.

(22) Thrall v. Guiney, 141 Mich. 392.

(23) Tappan v. Merchant's Bank, 19 Wall. 490.

(24) Veazie Bank v. Fenno, 8 Wall. 533.

without giving any reason for so doing. Vested property rights are not destroyed however by such repeal (25); if the power to repeal is reserved upon the happening of some condition, some cases hold that there must be a judicial determination that the condition has happened, before the legislature can act; other cases hold that the matter is wholly within the power of the legislature to determine. The courts are not altogether in accord as to the effect of the repeal of general corporation laws—whether they affect the existence of corporations formed under them or not. If the power to repeal is reserved, the effect of such repeal seems to be merely a question of legislative intent, with the presumption that existing corporations are not affected, unless clearly so intended.

No reserve power is necessary for forfeiting corporate franchises for abuse or non-use; this power is implied from the nature of a franchise, and can be enforced only in the courts after a proper judicial determination of the facts. A court of law alone has the power to dissolve for breach of duty, and generally only on the complaint of the state by the attorney-general.

§ 171. **Amendment.** Since a charter is a contract, the general rule here is that it can be amended only by consent of both parties, that is, the state and the corporation; and further, since there is also contained in the charter a contract between the corporation and each member, the corporation cannot accept an amendment unless each member consents; and this is the rule in this country concerning material amendments, when the state has not

(25) People v. O'Brien, 111 N. Y. 1.

reserved the power to amend. Under the transcendent power of Parliament, however, a material amendment could be imposed upon the corporation without its consent or that of its members—or they could be required to stop business. Perhaps Congress has a like arbitrary power as to corporations created by it. Under a reserved power to amend, the states have much the same power as Parliament—that is an amendment, even though material, may be tendered, and, if not accepted, the state may take away the corporate life (26). But in this connection it has been held that what the state offers must be an *amendment,* not something wholly new and different, such as requiring a banking company to build a railroad.

Two views are taken, also, as to the power of the majority to accept an amendment, if the power to amend is reserved to the state when the corporation is formed. One line of cases holds that the majority have the power to accept what are generally considered material amendments, against the dissent of the minority; other cases hold that unanimous consent is necessary. The difference here is more as to what constitutes a material amendment, than as to the rules relating to its acceptance. One case holds that extending a railroad from 60 to 90 miles is immaterial, and a majority may accept such an amendment (27); while another holds that extending a 5 mile railroad to 12 miles is material and requires unanimous consent (28).

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(26) Yeaton v. Bank, 21 Gratt. (Va.) 593.
(27) Buffalo, etc. R. Co. v. Dudley, 14 N. Y. 336.
(28) Zabriskie v. Hackensack Ry. Co., 18 N. J. Eq. 178.

SECTION 2. THE STATE AND NATIONAL CORPORATIONS.

§ 172. **In general.** National corporations are not foreign corporations in any state, unless they are created to operate in one of the territories or in the District of Columbia; in which case their status is substantially the same as if created by the legislature of one of the states, Congress merely acting as the local legislature in these cases. But corporations created by the national government to perform its national functions, to operate in any state, are not foreign corporations in any state. By the national banking act, a national bank located in any particular state is for most purposes treated as a citizen or inhabitant of that state; it, however, cannot be taxed in such states, or the exercise of its powers be restricted by the state where located, in any other way than as is expressly authorized by the national laws. For example, where the statutes of Pennsylvania provided that no foreign corporations should have an office in that state, without obtaining a license from the state, for which an annual charge was made, it was held that a railroad company chartered by Congress to build a road from Texas to California, and having an office in Philadelphia, was not a foreign corporation in that state, and subject to the license law thereof relating to foreign corporations (29).

SECTION 3. THE STATE AND FOREIGN CORPORATIONS.

§ 173. **Right of a foreign corporation.** Strictly speaking the states of the Union are foreign to each other in most matters relating to corporation laws; the owner-

(29) Comm. v. Texas & Pac. Ry., 98 Pa. St. 90.

ship of property, so long as it is legal in any state, by a corporation organized in another state, is protected as the property of an individual is, and, so long as its acts within the state are legal, it is protected by the national constitutional provisions. Its rights, however, to do business (except interstate commerce) in another state than the one creating it, is based upon mere *comity* and cannot be claimed as a legal right; it has the *power* to do business anywhere (if not limited by its charter), but its *right* to do business, in any other state than the one creating it, depends upon the consent of the state where it seeks to do business. Thus, where a Georgia bank had a general power to purchase bills of exchange, a purchase made by it in Alabama, without objection on the part of that state, is a valid exercise of corporate powers (30). So, an Indiana corporation, which through an agent in Louisiana sells meats in that state, can be charged an annual license tax upon the business done locally by the agent in the state (31), though the license tax is higher than the license tax charged to domestic corporations engaged in the same business. But where the goods are shipped by a foreign corporation, in distinct packages, to one in another state who took orders for them, and who examines them, and, if found all right, delivers them, collects the price, and remits to the corporation, such transactions are interstate commerce, and cannot be prevented or taxed by the states (32).

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(30) Bank of Augusta v. Earle, 13 Pet. 519.
(31) State v. Packing Co., 110 La. 180.
(32) Rearick v. Pennsylvania, 203 U. S. 507.

§ 174. **Right to engage in commerce.** While the general rule, as stated above, prevents a foreign corporation from entering, and establishing a place of business, and exercising its corporate franchise there, without the consent of the state, any corporation, just as a natural person, under the national Constitution, has the right to engage in interstate or foreign commerce—and this cannot be excluded or controlled by any state. Thus, where an Ohio manufacturing company, through its agents, made a contract in Colorado to make in Ohio and deliver in Colorado, an engine, the corporation could sue in Colorado for the price, though it had not complied with the statutes of Corolado in regard to doing business in that state as a foreign corporation (33). The questions, what is interstate commerce, when it begins and ends, and what incidents of it may be regulated by the state, are fully discussed in Constitutional Law, Chapter XIV, in Volume XII of this work.

§ 175. **Right of state to exclude.** Within the limits above given, any state has a legal right to exclude or discriminate against any corporation organized in another state (that is not an agent of the national government), for any reason or without any reason. And, after it has once granted a license to do business in the state, this license can be revoked at any time, though a valuable consideration was paid for it, without violating the national constitutional provisions; but, if the grant indicates a "contract right to do business in the state, during the corporate lifetime without being subject to any greater lia-

(33) Cooper Mfg. Co. v. Ferguson, 113 U. S. 727.

bilities than then were or might be imposed upon domestic corporations,'' the state cannot change the terms without consent of the foreign corporation, nor exclude it for not consenting (34). As an illustration of the general rule, it was held that where foreign insurance companies had been licensed to do business in the state, and had done so for many years, paying the license tax regularly, a new license tax could be imposed upon such corporations from other states of 2½%, and on those from other countries of 3½%, upon premiums paid in the state, although domestic corporations were required to pay only one per cent (35).

§ 176. **Methods of exclusion or restriction.** The statutes usually provide: (1) That, before doing business in a state, a foreign corporation shall appoint some one within the state, upon whom service of summons in suits against the corporation shall be made; (2) that, when the corporations of state A are excluded by state B then state A will exclude the corporations of state B—these are called retaliatory laws; (3) that suits against such foreign corporations shall not be removed by it to the Federal courts. While a provision of this latter kind cannot prevent the removal of a suit to the Federal courts, the state may afterward exclude the foreign corporation, that so offends, from doing business in the state (36).

Certain penalties are usually provided for violating these provisions. The state can collect the penalty or

(34) American S. & R. Co. v. Colorado, 204 U. S. 103.
(35) Manchester Fire Ins. Co. v. Herriott, 91 Fed. 711.
(36) Doyle v. Ins. Co., 94 U. S. 535.

oust the corporation for non-compliance. Much controversy has arisen as to the validity of contracts made with a corporation that has failed to comply (37); the weight of authority probably is that if a penalty is imposed, either on the offending corporation or its agent, that is the exclusive remedy, the validity of the contract is not affected, and it may be enforced; this is particularly true when the complaining party, who seeks performance of the contract, is the person contracting with the corporation, since such a provision is specially designed for his protection; and, if the corporation is complainant, many of the cases hold it can enforce a contract made by it before it complied with the law, but others hold otherwise. Another view is that, if there is no penalty and the corporation has not complied, the contract is void and unenforceable by either party to it. This does not seem reasonable, so far as complaint is made by one contracting with the corporation, since the law is designed for his protection instead of his injury. The courts also are not in accord upon what is "doing business," in violation of these statutes; one line of cases holds a single act of the kind the corporation was formed to do, if done without compliance with such statutes, violates them; while others hold there must be several acts, amounting to "carrying on" business.

§ 177. **Visitorial power over foreign corporations.** In general, a state has no visitorial power over the internal concerns of a foreign corporation doing business within its territory, except so far as it has compelled it to be-

(37) Toledo Tie Co. v. Thomas, 33 W. Va. 566.

come a domestic corporation, as a condition of doing business within the state. It may, of course, oust it from the state, but cannot dissolve it; it may appoint a receiver for such corporations as are doing business within the state and have property there; but, if it has no place of business within the state or no officers or no property there, it cannot do so. What are "visitorial powers" and what are "internal concerns" are not very definitely settled: but to compel an assessment upon the stock; or "to entertain an action to dissolve a corporation; to determine the validity of its organization; to determine which of two rival organizations is the legal one, or who of rival claimants are its legal officers; to restrain it from declaring a dividend, or to compel it to declare one; to restrain it from issuing bonds or from making an additional issue of stock—would clearly all be the exercise of visitorial powers over the corporation, or an interference with the management of its internal affairs" (38); yet, to compel the issue of a new certificate of stock to replace a lost one, or to direct the corporation to allow a member to inspect the corporate books already in the state, are not such as are beyond the power of the state to enforce.

Section 4. The National Government and State Corporations.

§ 178. **Taxing power.** Under the taxing power of the United States government, it has been held that state banks with power to issue bills and notes can be taxed by the national government so heavily as to make it im-

(38) Guilford v. W. U. Tel. Co., 59 Minn. 332.

possible for them to do a profitable business of this kind, and this is true even if the national government did this for the express purpose of protecting the national bank issues and destroying the state bank issues (39). This power has been suggested to be such that state corporations which engage in interstate commerce can be taxed so heavily by the national government upon such business that they cannot profitably do such business, and, in that way, the national government can control, by naming conditions or requiring a license, the recent corporate trusts. No case has yet been decided, but the legislation of Congress just enacted as a part of the tariff programme, providing a tax upon corporate net earnings, may be the first step in that direction. In the case of the bank it was allowed to reorganize as a national bank and thereby come directly under the national control (40). It seems that this method might be used to compel corporations engaged in interstate commerce to incorporate as national corporations, if a Federal law were enacted for that purpose. Much of the vexatious variety of state legislation, now casting a great burden of expense upon such corporations in order to comply with it, might be avoided and uniformity obtained thereby.

§ 179. **Adopting state regulations.** Undoubtedly, though Congress has exclusive regulation of interstate commerce, it may adopt regulations made by the states that have the effect to exclude corporations or others from carrying on business that they otherwise would have the

(39) Veazie Bank v. Fenno, 8 Wall. 533.
(40) Casey v. Galli, 94 U. S. 673.

right to do, against the state's consent, as interstate commerce. In this way the national law makes it illegal to sell interstate liquor in any state that has a prohibitory liquor law, contrary to that law.

CHAPTER VI.

SPECIAL RELATIONS.

SECTION 1. THE CORPORATION AND ITS PROMOTERS.

§ 180. **Duties of promoters.** The promoters owe to the corporation the general duty to take no advantage of it; if they, while engaged in promoting the company, *buy property for the corporation,* they must let the corporation have it at the price paid by them for it; this is because they are in a relation of trust toward the unborn corporation, when they are acting for it (1). If they own property, and purchase it from themselves for the corporation, while engaged in promoting the corporation, they must not pay more than the property is worth. If they own or acquire property for themselves, while not acting for the corporation, they have the perfect right to sell it to the corporation at any price they can obtain, provided they do not themselves, or by their dummies, represent the corporation in making the purchase. These last two statements, however, are probably subject to the qualification that, if the promoters are themselves the only parties interested in the corporation at the time and no public subscription for shares is to be called for, or, if all the shareholders know all the facts and ratify the acts or do not object, a large amount of stock may be

(1) Chandler v. Bacon, 30 Fed. 538. See 54 Am. L. Reg. 65, 123.

issued for property of little value, and purchasers of shares from original shareholders, who took their shares with full knowledge of the facts, cannot complain. Only creditors, without knowledge, can complain that the stock is unpaid, when the corporate funds are insufficient to pay their claims. There are however some conflicting views upon these matters.

§ **181. Same: Illustration.** T and A on January 20 signed articles of incorporation of a railroad company; on February 17 bought 40 miles of a graded railroad bed, with right of way, for $15,000; on February 20 filed the articles of association, at which time corporate life began, the company to have $3,600,000 capital stock; immediately thereafter organized by electing themselves and two others, to whom they had sold an interest in the roadbed, directors and officers of the company; in May offered to sell the roadbed to the company for the $3,600,000 capital stock and $200,000 in money; in November this offer was accepted by the directors and the stock ordered transferred to the owners of the roadbed; this was then done; a little later at a meeting of the stockholders, who so received their stock, all being present, a resolution was unanimously passed approving and ratifying the foregoing transactions. In a suit by the company, after these parties had sold their stock to others, to have these transactions set aside, and the stock and money, above the $15,000 paid by the parties for the roadbed, returned to the company, it was held there was no liability (2).

(2) St. Louis, etc. Co. v. Tiernan, 37 Kan. 606. Compare Old Dominion Copper Co. v. Bigelow, 188 Mass. 315, and Old Dominion Copper Co. v. Lewisohn, 210 U. S. 206.

§ 182. Liabilities to corporation or its shareholders. For all profits made by them in promoting the company, or while acting for it, promoters are liable to the corporation or its shareholders, when the public are to be called on generally for subscription to shares and full information is not given to the subscribers, or they are misled into believing no profits are made or to be made. Thus, where K obtained an option from V to purchase a tract of land for $31,000, and then associated P with him for the purpose of organizing a corporation for the purchase of the same land for $55,000, and prepared a subscription paper so worded as not to disclose the true ownership of the land, but to induce the signers to believe it belonged to V, and to bind them to join in forming a corporation to purchase such land for $55,000; and, in order to induce the signers to believe that K and P purposed to become stockholders on the same basis as the others who joined in the apparently mutual enterprise, each signed for $10,000 of stock, and the corporation was formed, K and P elected directors and managing officers, and the sale was completed, ostensibly by V, for $55,000, but really for $31,000, K and P dividing the difference—the other subscribers may in equity have the contract rescinded and recover their money, or may charge K and P as trustees for the profits and have an accounting, or may sue them at law for damages for fraud (3). On the other hand, where the promoter similarly acquired an option on property for $6,000 and organized a corporation to purchase it, but, in his subscription paper, described the land proposed to

(3) Hebgen v. Koeffler, 97 Wis. 313.

be purchased and stated "I hold the option and agree to sell all my rights therein to said company for $8,500 when it is organized," neither the company nor any subscriber could complain that the promoter made a profit of $2,500, since he did not pretend to be selling the property of another party, and going in with the subscribers on a pretended equality to purchase it at a price not known to them but known to him to be false (4).

§ **183. Liability to party dealt with.** Promoters are personally liable to one dealing with them, even though their dealing is in the name of the corporation, for the reason that there is in fact no principal in existence that they can represent (5). This liability perhaps can be excluded by drawing the contract in a way that makes the corporation alone liable, if any one.

§ **184. Liability among themselves.** As between themselves, so far as they act in forwarding the scheme of incorporation in accordance with their agreement, they are substantially partners for the particular purpose, and one is bound by the acts of the others in carrying out the scheme in the way contemplated. But, as to the other matters, only those who authorize, consent, or ratify the acts of the others become liable therefor (6).

§ **185. Liability of corporation for acts of promoters.** Inasmuch as the corporation does not come into existence, until after the promoters' acts bring it into existence, it

(4) Richardson v. Graham, 45 W. Va. 134.

(5) Weatherford, etc. Co. v. Granger, 86 Tex. 350; Hinkley v. Oil Co., 132 Ia. 396.

(6) Pirtsch v. Milbrath, 123 Wis. 647; Roberts, etc. Co. v. Schlick, 62 Minn. 332.

cannot be a party to a contract made for it by its promoter, and so is not liable thereon, unless it expressly or impliedly adopts the acts or contract after it has come into perfect existence (7). The adoption of a promoter's contract by the corporation is really making a new contract, which dates from the time of adoption and must be entered into with all the formalities then required to bind the corporation (8); and this is not properly termed a ratification, for that implies the existence of a principal at the time the agent makes the contract. See Agency, § 22, in Volume I of this work.

SECTION 2. THE CORPORATION AND ITS OFFICERS.

§ **186. General relation.** There are three theories as to this relation: (1) That the officers, including directors, are merely *agents* of the corporation or the shareholders; this is not quite correct, for the directors have the power to act in good faith in a way that does not coincide with the shareholder's view. (2) That they are *trustees;* this view is not entirely correct, for there is no separation of the titles to the corporate property into legal and equitable, and a vesting of the legal title in the trustees and of the equitable title in the corporation, as there would be in the case of a true trust. (3) That they are *mandataries*; this is not altogether correct, for there is no vesting of the legal possession of the corporate property in them as a special property, as there is in the case of bailees. The truth is the relation of directors and officers

(7) See note 5, above.

(8) McArthur v. Times Co., 48 Minn. 319.

is sui generis, involving relations analogous to all of the above, but not exactly the same as either.

These theories may be illustrated thus: A shareholder brought an action on the case for damages against the director of a bank for loaning money without security. Held, such suit could not be maintained—the corporation must sue, for the director was *its agent* (9). A receiver of a corporation brought a bill in equity against a director for misappropriating the corporate funds to his own use; held, in Illinois, that the director was the trustee of an express trust, and could not successfully plead the statute of limitations for that reason (10). On the same facts, Tennessee holds the directors are only implied trustees, and statutes of limitations run in their favor (11).

§ 187. **General rule as to duties.** They owe the corporation the duty to exercise diligence and care and a reasonable business judgment and prudence in managing the corporate affairs, and, for failure in this direction, they may be held in an action for damages by the corporation (12); some cases say they are liable only for gross negligence in managing the corporate affairs, or selecting unfit servants, or failure to use ordinary care to supervise their acts afterward (13); they have no right to any profits made by them while working for the corporation; all such belong to it and may be recovered by it.

§ 188. **Right to remove corporate officers.** There is no

(9) Allen v. Curtis, 26 Conn. 456.
(10) Ellis v. Ward, 137 Ill. 509.
(11) Wallace v. Sav. Bank, 89 Tenn. 630.
(12) North Hud. Bldg., etc. Assn. v. Childs, 82 Wis. 460.
(13) Swentzell v. Penn. Bank, 147 Pa. St. 140.

well-defined power to remove elected officers—as directors, president, etc.—who are elected for terms fixed in the charter, general law, or by-law, before the term has expired (14); this may be provided for by by-law provision allowing it; a court could, upon proper showing, remove such officer if he were violating his trust, in a way similar to the removal of other trustees. Agents, though hired for a definite time, may be removed, subject to liability for damages if removed without cause before their time of service has expired; if not hired for a definite time, they can be removed at any time by the corporation without making itself liable for damages.

§ 189. **Rights of officers to manage the corporate business.** So long as corporate officers act in good faith, with due care, and keep within the corporate powers and those conferred upon them, they cannot be prevented from managing the business according to their best judgment, and neither shareholders nor the courts can interfere (15).

§ 190. **Right of officers to deal with the corporation.** The general rule here is that the officer cannot rightfully represent both himself and the corporation in making a contract with it; any such contract is voidable by the corporation or its members, even though in fact it was fair and reasonable, by one line of cases (16); but by another and perhaps the better view, if the contract is made in good faith and free from fraud, it is not so voidable (17). If the corporation, however, is represented by other

(14) In the Matter of Election of Directors, 63 N. J. L. 168.
(15) Blood v. La Serena, 113 Calif. 221.
(16) Munson v. Ry. Co., 103 N. Y. 58.
(17) Twin Lick Oil Co. v. Marbury, 91 U. S. 587.

officers that have power to act for it in the transaction, there is nothing forbidding an officer from dealing with it, and such contract is valid. The same rule applies to corporations having common directors or officers (18) dealing with each other through such officers; if they are represented by non-common officers who could bind it by their action, the contract is valid; otherwise voidable.

§ 191. **Right to salary.** The general officers of corporations, including directors, are supposed to serve in their capacities as such without compensation, and hence, after they have so acted, they cannot, without consent of shareholders, be voted salaries as back pay (19), for such a thing would be giving away the corporate funds. For any extraordinary service not included in the ordinary functions of the office, there is an implied promise to pay, and in such case the directors have the right to fix the amount. The shareholders usually reserve the right to themselves to fix the salaries of the general officers, and leave to the directors the right to fix other salaries. There is an implied promise to pay any officer or any person, who devotes his whole time to the service of the company in ways other than merely performing the duties of his office.

§ 192. **Right of officers to resign.** A corporate officer may resign at any time, even though the statute provides they shall continue in office until their successors are appointed, and this may be done without giving notice to the public or to those dealing with the corporation (20).

(18) Aldine, etc. Co. v. Phillips, 129 Mich. 240.
(19) National Loan, etc. Co. v. Rockland Co., 94 Fed. 335.
(20) Briggs v. Spaulding, 141 U. S. 132.

No acceptance of the resignation is necessary to make it effectual. But the resignation of officers for the purpose of preventing the bringing of any suit, or the service of process, or of enabling a receiver to be appointed, is ineffective. Salary and liability cease with the resignation (21).

§ 193. **Right of officers to deal with shareholders.** There is some conflict upon this matter. It is usual to say that directors and officers do not stand in any relation of trust and confidence toward individual shareholders, and consequently can deal with them as if they were strangers, and are not obliged to give them any information unless called for, that may affect the value of the shares, even though they seek to buy shares from such shareholders (22); but there are some recent cases to the contrary, including a decision of the Supreme Court of the United States, reversing a decision of the supreme court of the Philippine Islands (23). It was held here that the managing director of a church-landowning corporation, having shares, and whose lands were about to be purchased by the government at a price that would greatly enhance the value of the shares, was under a duty to inform a shareholder from whom he sought to purchase shares, of the facts known to him concerning the probable sale of land to the government.

§ 194. **Right to contribution.** Where directors wrongfully pay dividends out of capital to shareholders who know the facts, and such directors are held liable to

(21) Zeltner v. Brewing Co., 174 N. Y. 247.
(22) Deaderick v. Wilson, 8 Baxter (Tenn.) 108.
(23) Strong v. Repide, 213 U. S. 419.

creditors for the amount so paid, they can recover the amount from the shareholders who knowingly received it; but, if the shareholders did not know the facts, they would not be compelled to refund (24). And where directors jointly wrongfully waste the corporate funds, one who has been compelled to make good the loss cannot enforce contributions from the others (24), the ordinary rule relating to joint wrong-doers applying.

§ 195. Liability of officers. The liability of officers to the corporation is considered above, and to the shareholders and creditors hereafter. To third parties, or to those who deal with the corporation, the corporate officers are liable for their own wrongful acts, and cannot shield themselves behind the liability of the corporation as their principal. Thus, where an officer, without authority to issue a note for the company, falsely claimed he had such authority, he is liable to an innocent holder of the note; but, if he had authority to issue notes for a proper purpose and abuses that authority, he is liable not to the innocent holder but to the company, which is liable to the holder (25). So, too, where the manager of a lumber company put a known inexperienced workman to work with a defective machine known to be dangerous, whereby the workman was hurt, the act of the manager was not mere non-feasance, but a misfeasance for which he is liable (26). So, also, a manager who keeps giant powder

(24) Moxham v. Grant, 69 L. J. (Q. B.) 97.
(25) Dexter Sav. Bk. v. Friend, 90 Fed. 703.
(26) Greenberg v. Lumber Co., 90 Wis. 225.

in a dangerous quantity and place, for a corporation, is liable for the damage due to explosion (27).

SECTION 3. THE CORPORATION AND ITS SHAREHOLDERS.

§ 196. **In general.** The corporation has a right not to have its existence denied by its shareholders—they are estopped; it has a right to issue preferred stock under some circumstances; to regulate transfers; to carry on the enterprise as the majority of the directors shall direct; to accept amendments, under some circumstances by a majority vote, and, if in failing circumstances, to dissolve itself. These matters have been considered.

§ 197. **Right of corporation to collect subscriptions.** In all the states except those of New England, every subscription to stock that does not so state otherwise is considered as including an implied promise to pay for the shares when the corporation needs the money (28); it is not usually a debt due immediately upon the subscription (though some statutes make part of it such), but only an agreement to pay when demanded by the proper corporate authorities.

§ 198. **Calls.** Before any particular amount is due upon any subscription a *call* is to be made by the directors; this at common law was simply passing a resolution saying that a certain per cent of the amount subscribed should be due and payable at a certain time (29). Every shareholder was supposed to take notice of such resolu-

(27) Cameron v. Kenyon Connell Co., 22 Mont. 312.

(28) Gettysburg Natl. Bk. v. Brown, 95 Md. 367; Hughes v. Mfg. Co., 34 Md. 316.

(29) Budd v. Multonomah Co., 15 Ore. 413.

tion, and was in default if he did not comply with it; it is usual now to require notice of some sort to be given of the fact of making the call, and also of the time and place it shall be payable. It becomes a debt due the corporation as soon as due, and may be sued for by the corporation; to be valid, calls must operate equally and be uniform on all. There is no right, unless expressly conferred, to call for any more than the face value of the amount subscribed, or the amount agreed to be paid in the subscription contract (30). Calls should be made by directors legally elected (31).

§ 199. **Evidence of membership.** The cases are not agreed as to this; one line of authorities holds that the corporate records, such as the stock and transfer books, are prima facie evidence as to who is a member, even against one who does not claim membership (32); the better view is otherwise (33). Such records would properly be evidence of membership against the corporation, and, with some propriety, might be considered such in favor of corporate creditors. Such records are not, however, conclusive. A certificate of shares is not necessary to constitute one a shareholder.

§ 200. **Right to vote.** At common law every member had a right to one vote on every proposition, and no more. Voting was not according to shares owned; now, by custom, by-law, and statute or charter, the rule is almost universally the other way, and a shareholder has one

(30) Enterprise Ditch Co. v. Moffitt, 58 Neb. 642.
(31) Moses v. Tompkins, 84 Ala. 613.
(32) Glenn v. Orr, 96 N. C. 413.
(33) Carey v. Williams, 79 Fed. 906.

vote for each share owned (34). Preferred stock may be issued without the right to vote, though the statute says each share shall be entitled to one vote (35). The holder of the legal title has the right to vote; executors and administrators vote the stock belonging to the estate before distribution; the corporation cannot vote its own shares held by itself; a shareholder can vote as he sees his personal interest, even though such is in conflict with the corporate interest; but, if he owns a majority of the stock, he must not commit a fraud, or deprive the minority shareholders of their legal rights in the corporate business and profits.

§ 201. **Proxy.** At common law the member, unless the charter expressly authorized, had no right to vote by proxy, but must vote in person (35); now, statutes universally allow voting by proxy, which is simply the appointing by the shareholder of some one to be his proxy or attorney in fact to attend a certain meeting and vote all the shares that his principal owns, upon all questions lawfully coming before that meeting, as fully as the owner could if he were present. No special form is essential, unless by-laws, charter, or statutes expressly so require.

§ 202. **Irrevocable proxy.** There have been some attempts to make proxies irrevocable—but they cannot be so made, even for a consideration; they are considered such a separation of the interest in the stock and in its control as are contrary to public policy; hence, anyone

(34) Comm. v. Detwiler. 131 Pa. St. 614.
(35) State v. Swanger, 190 Mo. 561.

that has given an irrevocable proxy can cancel it at any time (36).

§ 203. **Voting trusts.** Voting trusts are agreements among shareholders to vote all the shares they own in the way the majority of the parties to the agreement direct, or in the way some trustee or outside party shall direct; when entered into for the purpose, and having the effect of placing the control in a minority of the shareholders, they have generally been held voidable and unenforceable at the option of any party to the agreement (37). In some cases, where they serve the purpose of sustaining or preserving rights that otherwise might be in peril they have been upheld (38); and they are generally upheld in California and New York, the latter having expressly legalized them by statute.

§ 204. **Cumulative voting.** This is a method authorized by statute, which allows the minority of shareholders a chance to obtain representation upon the directorate. If A owns ten shares of stock in a corporation having five directors, he would have the right to vote ten shares for each director separately, and this is the usual and the only way unless some other method is expressly provided. The cumulative method would permit A, instead of casting 10 votes for each of five directors, to cumulate them and cast the entire 50 votes for one and none for the others, or 25 for each of two directors to be elected, or in any other way to divide his votes, not exceeding 50 in all (39).

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(36) Cook, Stock and Stockholders, §§ 610, 622.
(37) Harvey v. Linville Co., 118 N. C. 693.
(38) Smith v. San Francisco, etc. Co., 115 Calif. 584.
(39) Pierce v. Comm. 104 Pa. St. 150.

Under the reserved power to amend, a corporate charter can be amended, and the amendment can be accepted by a majority of shareholders against the protest of the minority, authorizing cumulative voting (40).

§ 205. **Dividends.** A dividend is a sum set aside out of the corporate profits to be divided among the shareholders in proportion to their holdings; dividends must, in order to be valid, be declared out of the corporate profits—that is, the balance after all current expenses of operation are paid, and fixed charges and losses in capital are provided for. When the corporation has earned profits which could be applied to the payment of dividends, and also has the power to increase its shares of stock, it may keep the money and declare a *stock* dividend by issuing shares instead, to an amount in face value equal to the profits to be divided (41). Before dividends belong to the shareholder and cease to be the property of the corporation, they must be *declared* by the board of directors, and the *funds set aside* to pay them; from that time the shareholder is considered part owner of the fund so set aside, though not yet due (42); without this setting aside of a particular fund or amount, out of which payment is to be made, the shareholder is a mere creditor to the amount declared, and must share with the other creditors in case insolvency afterward occurs before payment (43). The shareholder must, however, demand payment, before the corporation is in default for non-payment;

(40) Looker v. Maynard, 179 U. S. 46.
(41) Williams v. W. U. Tel. Co., 93 N. Y. 162.
(42) Le Roy v. Globe Ins. Co., 2 Edw. Ch. (N. Y.) 657.
(43) Hunt v. O'Shea, 69 N. H. 600.

after that, he can sue the company for refusing to pay, either in assumpsit or debt. The power to declare dividends resides in the directors, and, so long as they act in good faith in furthering the interests of the company according to their judgment, a court will not control their discretion in compelling the declaration and payment of a dividend; but, where they fraudulently withhold payment out of funds available, the court may order a distribution (44). And where preferred shareholders are entitled to receive their dividends annually, out of the profits earned during any one year, which are non-cumulative, a court of equity will order a dividend to be made, when there are net earnings properly divisible (45).

§ 206. **Who are entitled to dividends?** This of course is a matter of contract between the transferrer and the transferee; but, in the absence of any stipulation to the contrary, the owner of the shares at the time the dividends are *declared* is entitled to them, and it makes no difference when they were earned or when they are to be paid. As between the pledgor and the pledgee of shares, the latter is entitled to the dividends paid during the existence of the pledge, to be credited on his claim against the pledgor If A is the owner of shares when a dividend is declared, it belongs to him, though it does not become due until after A has transferred his shares to B. So, too, if A sells to B before a dividend is declared, it of right belongs to B, though it is declared before the transfer on the books is made to B; in this case, however, the corpora-

(44) Crichton v. Webb Press Co., 113 La. 167.

(45) Hazeltine v. Railroad Co., 79 Me. 411.

tion will be justified in paying A, if it has no knowledge of B's claim; and generally the corporation is protected if it in good faith pays to the registered owner. As between successive owners of shares, the rules given in the previous subsection relating to setting aside the dividend fund do not apply. The *declaration,* not the setting aside, is the important point.

Thus, where preferred stock was guaranteed a ten per cent dividend before the common stock, and no dividends were paid between 1857 and 1863, but afterwards such dividends were paid regularly and a large surplus accumulated; in 1870, P acquired 40 shares of preferred stock, and, in 1880, the corporation proposed to declare dividends out of the surplus on the common stock; P claimed that he was entitled to the dividends that should have been declared and paid in 1857-1863, and the court so held; since they were not then *declared,* the right to them passed to the successive owners of the stock until declared (47). B on April 1 agreed to sell shares to L on or before July 18, to be paid for on delivery, nothing being said about any dividends; July 3 a dividend was declared, payable August 1; L exercised his option July 16, and paid for the stock. Held, B was entitled to the dividend as he was the owner of the shares at the time it was declared (48).

§ 207. Between life tenant and remainder man. The cases are in conflict as to this; one rule is, that if the dividend is a money dividend, it is always to be paid to the life tenant as income; but, if it is a stock dividend, it is all

(47) Jermain v. L. S. & M. S. Ry., 91 N. Y. 484.
(48) Bright v. Lord, 51 Ind. 272.

to be paid to the remainder man as a part of the estate. Another rule is that if the dividend is ordinary; i. e., one arising from the ordinary operations of the company, it will all go to the life tenant; but, if extraordinary, such as declared out of capital when the stock is lawfully reduced, all of it should be paid to the remainder man. Another rule is that the intention of the corporation shall govern —what it declares to be earnings shall be treated as income and go to the life tenant; and what it considers capital shall be so considered and go to the remainder man. Another rule, and the one having the weight of authority, is that the courts will investigate when the fund was earned; if earned before the death of the person creating the tenancies for life and in remainder, it will go to the remainder man, as a part of the corpus of the estate; if in fact it represents earnings accumulated afterward, it will go to the life tenant, whether paid in money or stock (49).

§ 208. **Transfer of shares. Right to transfer.** The general method of transfer has been described. The certificate of stock usually says, "transferable in person or by attorney on the books of the corporation upon the surrender of this certificate." On the back, a blank form of assignment is usually present, reading, "For value received I hereby sell, assign, and transfer to ——————— all my interest in ———————— shares of stock represented by this certificate and I hereby irrevocably appoint ——————— my attorney to transfer the same on

(49) McLouth v. Hunt, 154 N. Y. 179. See note, 118 Am. St. R. 162.

the books of the corporation, with full power of substitution;" when this is signed by the owner, the certificate will pass by delivery without filling in the other blanks, and any subsequent holder can fill in the blanks and have his name put on the corporate books as owner, and get a new certificate in his own name to that effect (50). It has been said that writing is essential to the transfer of shares, since they are mere choses in action; but, while a written assignment is the universal custom, in the absence of special provision so requiring it is not necessary by the weight of authority. The right to transfer is an incident of the ownership of the property in the shares—and the corporation, unless the statute expressly allows, cannot prevent such transfer, although it may regulate it by reasonable provisions for the protection of the corporation (51). But at the time the subscription is made, the subscriber may, in some states, agree to offer his shares to the corporation or other members before selling to outside parties (52). There is no right generally recognized in this country to transfer shares after insolvency, or to an incompetent or insolvent person for the purpose of evading liability.

§ 209. **Registration of transfer.** There are two theories as to the necessity of the registration of the transfer on the books of the corporation; one is that the legal title does not pass by delivery of the certificate duly indorsed and assigned—registration being essential to pass the legal title, and only an equitable title passing without

(50) Keller v. Mfg. Co., 43 Mo. App. 84.
(51) Bloede Co. v. Bloede, 84 Md. 129.
(52) Barrett v. King, 181 Mass. 476.

(54); the other is that, as between the parties themselves and all other parties claiming through them, the whole title passes with the delivery of the certificate duly endorsed, with a power of attorney to have the transfer made on the books of the company (55). This latter is certainly supported by the great weight of authority. As between the corporation and the transferror or transferee, until the registration is made on the books of the company, the corporation may, until it is satisfied of the right of the transferee, recognize the registered owner (56). The above rules are of importance in the case of attaching creditors of the transferror, and give exactly opposite results. As between pledgor and pledgee, registration is unnecessary. But the pledgee, in order to prevent the possibility of loss, usually has the stock registered in his name. Where P indorsed his certificate of shares in blank and delivered it to B his broker to secure a balance of account of $3,000, and B, without authority, pledged the same shares by delivery of the indorsed certificate to a bank, to secure a loan of $8,000 to B, the bank, having no knowledge of the wrongful act of B, could hold the shares as against P, until the $8,000 loan was fully paid (57). But, if instead of claiming to own the shares and borrowing for himself, B had represented he was P's agent and wished to borrow for him, and had pledged the indorsed shares to the bank as security, and, after securing the money, appropriated it himself, P could recover

(54) Perkins v. Lyons, 111 Ia. 192.
(55) Westminster, etc. Bank v. Electric Works, 73 N. H. 465.
(56) People's Bank v. Exchange Bk., 116 Ga. 820.
(57) McNeil v. Tenth Natl. Bk., 46 N. Y. 325.

the shares and the bank would lose, since it relied on B's false representation of agency (58).

§ 210. **Transfer upon forged power of attorney.** Since certificates of shares are not negotiable, this has no legal effect upon the rights of the original owner—he cannot be deprived of his property by the forgery, unless he is chargeable with negligence (59). If the corporation accepts and cancels a forged certificate, and issues a new one in its place, a bona-fide purchaser of the new certificate is protected, and, as against the corporation, may claim membership, unless the corporation has issued all the shares it can; but, if the corporation has issued all the shares it has a right to issue, the purchaser has an action for damages against the corporation. The certificate is a continuing representation of the validity of the shares, when made to an innocent party; the original owner can claim the rights of membership; the forger or the person who induces the corporation to act is liable to it for any loss it sustains. The same rules apply to lost certificates not due to the fault of the owner. Thus, where a certificate was issued to D and by him sold and indorsed in blank to P, from whom it was stolen without his fault by an unknown person, who transferred it to brokers who sold it to M, P can recover the shares and M and the brokers must look to the thief (60).

§ 211. **Transfers in breach of trust.** When A holds shares in trust for B, and there is nothing in the certificates or on the register to show that a trust exists, a bona

(58) Merchants' Bk. v. Livingston, 74 N. Y. 223.
(59) Telegraph Co. v. Davenport, 97 U. S. 369.
(60) East Birmingham Land Co. v. Dennis, 85 Ala. 565.

fide purchaser from A gets a good title as against B, and B must look to A. If the certificate or register shows a trust exists, the purchaser takes it subject to the trust (61); if the corporation has knowledge of the existence of the trust and of any limit on the power of the trustee to transfer, and it negligently allows him to transfer contrary to his authority, the corporation is liable to the party injured (62).

§ **212. Gift.** A gift of shares may be made by delivery of the certificate for that purpose, without indorsement. Registration is not essential to the validity of the gift, though perhaps the full legal title is not complete, until indorsement on the certificate or transfer is made on the corporate books (63).

§ **213. Effect of transfer.** The general rule is that the transferror is no longer a member, and is no longer in any way liable to the corporation or its creditors, even though the shares are not fully paid; the purchaser, on the other hand, assumes, if he has knowledge of the facts, all the obligations and is entitled to all the rights of the seller (64). If he has no knowledge that the shares were not paid up, in the absence of any statute to the contrary, he is not liable to the corporation or to its creditors—he has a right to presume they are paid up, though the certificate does not so state, and he is not obliged to inquire into the matter (65). In such case it would seem the transferror

(61) Winter v. Gas Light Co., 89 Ala. 544.
(62) Loring v. Salisbury Mills, 125 Mass. 138.
(63) First Natl. Bk. v. Holland, 99 Va. 495.
(64) Visalia, etc. R. R. Co. v. Hyde, 110 Cal. 632.
(65) West Nashville, etc. Co. v. Nashville, etc. Bank, 86 Tenn. 252.

would remain liable to the corporation, at least so far as necessary to protect creditors. The matter is regulated by statutes in many states.

§ 214. **Remedy for refusal to transfer.** This is an action to recover the value of the shares, as damages—usually at the time of refusal, but, by some decisions, the value at the time of trial or the highest value at any time between the refusal and the trial (66); under some circumstances, where shares cannot be obtained, a court of equity, or a court of law by mandamus, will compel a transfer (67). The reason why the courts will not ordinarily compel a transfer is because there is no necessity of possessing the identical shares; by recovering the market value of them, they can usually be replaced.

§ 215. **Right to inspect books.** At common law a shareholder had the right to inspect the corporate books, whenever there was a real matter of controversy between him and the corporation, or its officers, or shareholders, which made it necessary to see the books; now, by statute generally, he has the right at reasonable times to see the books and take copies of the entries by himself or his agent, without there being an actual controversy existing; it must be exercised at a reasonable time; if refused, an action for damages will lie, or the custodian may be compelled by mandamus to permit inspection. Recently, even without statute, the courts have applied a much more liberal rule than formerly. Thus where a shareholder was simply "desirous of learning the true condi-

(66) Burdick, Torts, p. 205.
(67) Cushman v. Thayer, etc. Co., 76 N. Y. 365.

tion of the affairs of the company and the value of his interest therein," the corporation was compelled to allow the inspection; the reason being that the shareholders are in substance part owners of the corporate property (68).

§ 216. **Right to share in increase of stock.** Where the corporation has the right to increase its capital stock, each shareholder has a right to subscribe at par for such proportion of the new stock as his holdings are of the old stock, in preference to outside parties. Thus, where the corporation voted to increase its stock and offer it to shareholders at twenty-five per cent premium, in proportion to their holdings, and, if it was not taken by a certain date, to sell it to new stockholders; and the plaintiff offered to take his proportion at par, tendered the money, and was refused; he was entitled to a mandamus to compel the company to issue him his proportion of the new stock. The reason is that the shareholders are really the owners of the corporate concern, and any other rule might diminish the value of each share of old stock by letting in other parties to an equal interest in the surplus and good will of an established business (69).

§ 217. **Right to sue for wrong done the corporation.** The general rule is that shareholders have no such right, the corporation being the proper party—but in some cases there would be a failure of justice if they were not allowed to sue. Whenever the corporation is *unable* to sue for a wrong done it, then a bona fide shareholder may, upon behalf of himself and all others, sue to have the

(68) State v. Pacific Brewing Co., 21 Wash. 451.

(69) Hammond v. Edison Illuminating Co., 131 Mich. 79.

wrong righted. The wrongs for which suit may be brought are the ultra vires acts of the agents, resulting in damages to the corporation; the fraudulent acts of the directors, or their acting in their own instead of the corporate interest; and oppressive or fraudulent acts of a majority of the stockholders. The plaintiff must allege and show that he tried to have corporate action taken through the proper corporate agencies to have the wrong righted, and that they refused, or that the wrongdoers were the corporate officers themselves who had authority to have the corporation sue. If the offense charged is one that the shareholders could ratify, the courts will not interfere until they have been called to pass upon the matter, unless delay would be perilous if a right existed (70).

SECTION 4. CREDITORS OF THE CORPORATION.

§ 218. **Creditors and the state.** As a general rule, the state, unless it has reserved the power to repeal or amend a charter cannot repeal or change the statutory *contractual* liability of shareholders, so as to impair the security of existing creditors; but the *penal* liability of shareholders may be repealed or changed, and, if the state has reserved the power to repeal, the contractual liability may be changed. Dissolution by the state does not affect creditors' rights; they are enforceable against the assets of the corporation. Remedies may be modified, provided they are not substantially taken away. Contractual and penal liabilities are defined below.

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(70) Hawes v. Oakland, 104 U. S. 450.

§ 219. **Creditors and the corporation.** Creditors have all the ordinary rights to enforce their claims against the corporation in the usual way in courts, that they would have against individuals; except that such property as is necessary for the corporation to perform some public duty cannot be taken on execution; but the income from it may be sequestrated in equity or otherwise to pay the claims (71). Creditors have no right to interfere with or dictate the manner in which the corporation is managed (72). The reason for this is that they have no interest in the matter, other than to be paid what is due them when it is due.

§ 220. **Preference of creditors.** The corporation, by the great weight of authority, has the same right to prefer a creditor in case of insolvency that an individual has; where this rule applies, a bona fide shareholding creditor or a director-creditor can be preferred also (73). In some of the states it is held that, as soon as insolvency occurs, the assets of the corporation become a trust fund for distribution among all the creditors in proportion to their claims, and the corporation can give no preferences (74).

§ 221. **Assets as a trust fund** (75). The general doctrine is that the capital of a corporation is a fund set apart for the protection of creditors, and cannot be given away or distributed among shareholders, until creditors are fully paid; that there is included in this fund not only

(71) Louisville, etc. Ry. v. Boney, 117 Ind. 511.

(72) Pond v. Framingham, etc. Co., 130 Mass. 194.

(73) Corey v. Wadsworth, 118 Ala. 488.

(74) Rouse v. Merchants' Bank, 46 O. St. 493.

(75) Wood v. Dummer, 3 Mason 308; Hospes v. Car Co., 48 Minn. 174.

any property the corporation has, but the sums unpaid by the shareholders upon their stock subscriptions, so far as necessary to pay creditors who have relied thereon; also all claims due to the corporation from whatever source can, in some form of proceeding, be recovered and applied to the payment of creditors' claims; also all capital of the company distributed to the shareholders, that has the effect of reducing the property below the amount of capital stock that the corporation is to have, can be recovered so far as necessary to pay creditors who have relied thereon before extending credit, and provided the shareholders did not innocently receive it. A creditor, who becomes such before an increase of stock is made, cannot complain of its non-payment—for he does not rely on it; so a subsequent creditor can not complain of a previous improper disposition of the corporate property, if he did not extend credit in reliance upon the corporation still having such property.

§ 222. **Right of creditor to prevent dissipation of funds.** As has been stated, the creditors have no right to interfere in the corporate management; but the cases have generally recognized the right of creditors to enjoin threatened wrongs which would destroy the creditors' security, or enjoin waste of the corporate funds, or have conveyances in fraud of their rights set aside. In such cases the creditor must first establish his claim by a judgment at law, or in some other way obtain a lien upon the corporate assets, before a court of equity will give him such relief, and he must usually sue in such form as will

allow other creditors to join him, and have the assets administered for the benefit of all (76).

§ 223. **Creditors and officers.** So long as officers keep within their authority, they do not make themselves liable to creditors upon contracts they make for the company; if they exceed their authority, they become liable to those with whom they contract; if they commit a tort while acting for the company, they are liable therefor to the person injured, although the corporation may be also; the directors may be liable for tort for permitting such management of the corporation as creates a nuisance; under some circumstances, if they are negligent in managing the corporate affairs so the corporation would have an action for damages against them, upon insolvency, such a claim for damages is an asset which the creditors have a right to have enforced against the officers, if necessary to pay their claims.

§ 224. **Statutory liability of officers.** In some of the states where officers fail to make certain reports, or make false ones, or incur debts in excess of a certain amount, they are made liable for the debts of the corporation; in such cases the statutory method of recovery, if any is fixed, must be followed; but courts will allow recovery in some of the ordinary forms of proceeding, if no special form is provided.

§ 225. **Creditors and shareholders.** Creditors have no rights against shareholders, in the absence of a special statutory liability, provided the corporation is de jure,

(76) Hollins v. Brierfield Coal Co., 150 U. S. 371.

the face value of the stock has been fully paid in, and there has been no distribution of the capital stock before creditors are paid. The liability of shareholders arises in one of two ways: (1) From the common law; and, (2) under special statutes. The common law liability arises principally under three circumstances: (a) Imperfect organization; (b) failure to pay in the full amount subscribed; (c) payment of dividends out of capital instead of profits.

§ 226. **Common law liabilities of shareholders to creditors.** The first of these, arising out of imperfect organization, is based upon the rule that, when a number of persons undertake a business transaction and fail to become incorporated, the common law partnership liability results; as we have seen, if the corporation is de facto, the weight of authority holds that there is no other than the corporate liability, and not the partnership; and so too, where there is an estoppel against a particular creditor, he cannot hold the members to an individual partnership liability.

Second, since the capital stock is a fund for the protection of the creditors, it is in the nature of a fraud for the corporation or its shareholders to claim to have a capital stock up to a certain amount, which it has never received; the courts say that, for the protection of creditors and when necessary for the payment of those relying upon it, the shareholders will be required to make this representation good by making payment—this is what is usually

meant by saying that such subscriptions are a trust fund for the creditors' security (77).

In the third place, if the shareholders divide the corporate assets among themselves, before paying the creditors, the result is the same as if the capital had never been paid, and creditors who became such before the division have a right to have the sum so distributed paid back, so far as necessary to pay their claims. But shareholders who have innocently received dividends paid out of capital instead of profits, before insolvency, will not be required to refund (78).

§ 227. **Same: Procedure.** In these last two cases the creditor's rights arise only after he has established his claim by judgment against the corporation, has taken out execution against the corporate property, and has had it returned unsatisfied or partly so. Then he has the right to sue the shareholders in equity to have the sums due the corporation paid in to discharge his claims; he must usually bring a creditor's bill in such a way that the other creditors can come in and share in the proceeds in proportion to their claims (79). Judgment against the corporation is conclusive as to the debt of the corporation, and an assessment against the shareholders by the court cannot be questioned by the shareholder; but he can contest his liability on the ground that he is not a member, or that the judgment was fraudulently obtained. A receiver is usually appointed by the court, who can sue,

(77) Hospes v. Car Co., 48 Minn. 174.

(78) Davenport v. Lines, 72 Conn. 118; McDonald v. Williams, 174 U. S. 397.

(79) Lawrence v. Greenup, 97 Fed. 906.

by himself or by an ancillary receiver, any shareholder who owes the corporation, in any state to recover the amount so due; the liability of the shareholders is several, but it is usual in the suit to join all, though some are out of the jurisdiction of the court (80).

§ 228. **Non-payment of shares.** Under (b) in § 225, above, difficult questions arise as to the liability of shareholders who have an agreement with the corporation by which they are not to pay in full for their shares. Such agreements are valid as between the corporation and the shareholders, but are generally invalid as against creditors, so the creditor can require full payment for his protection.

There are four exceptions: (1) When the shareholder has *purchased* from another shareholder, in good faith, shares that were not in fact fully paid but which he supposed were, he is not liable to creditors for the unpaid amount. (2) When the corporation is in failing circumstances, but has the power to increase its stock, and it does this under stress of circumstances and in good faith to re-establish itself, it may sell such stock at its market value, or issue it as a bonus along with bonds issued, to tide over its difficulties; and those who take the stock or bonds or both, in good faith at their market value then, will not be held to any further liability in favor of subsequent creditors (81). (3) It is held in New York and Illinois that a corporation like a railroad company may issue its shares below par, or at their market value, in

(80) Stoddard v. Lum, 159 N. Y. 265.
(81) Handley v. Stutz, 139 U. S. 417.

payment of a construction company for the construction of its road, and such company is not liable to subsequent creditors for the difference between the face value of the shares, and the price at which they were taken (82). (4) In case shares are paid for in property, it is generally held that, so long as there is no actual fraud in valuing the property, whatever price it is taken at, even if it is an over-valuation, shall be final and creditors cannot complain; other states, notably Missouri, hold that any over-valuation, though made in good faith, must be paid back to the company by the person receiving the shares upon that basis, if necessary to pay creditors who have relied on the company having the capital it pretends to have. Many cases also hold that an excessive over-valuation is prima facie fraudulent, and the discrepancy will be required to be satisfactorily explained, or made up (83). Perhaps *good will* is property with which shares can be paid, if it really exists in the particular case; labor, services, patents, franchises, etc., are property within the rule.

§ **229. Statutory liability of shareholders to creditors.** This is a liability placed upon shareholders, over and above their common law liability, for the protection of creditors; it is not generally a part of the corporate funds for the purposes of carrying on its business, but it is a security for creditors alone; as to its legal character, it is either (1) contractual, or (2) penal. The contractual may be either (a) a joint and several, unlimited, primary

(82) Van Cott v. Van Brunt, 82 N. Y. 535.

(83) State Trust Co. v. Turner, 111 Ia. 664.

liability; (b) a joint and several, unlimited, secondary liability; or, (c) a limited, primary or secondary liability.

If *primary,* the liability arises at the time the liability of the corporation does; if *secondary,* only after the corporation is unable to pay; if *unlimited,* it is substantially that of a partner; if *limited,* then it extends only to the limit, which is usually a sum equal to the amount of the subscription in addition thereto, or such a proportion of the debts as the shareholder's shares are of the total shares. If it is primary, the statute of limitations would run at the same time it does against the corporation. If secondary, only after it was established that the corporation could not pay. It may be provided in constitutional or statutory provisions; if it is provided in constitutions, it will be self-executing whenever it is fixed in amount, and no special machinery for its enforcement is necessary.

§ **230. Contractual and penal liabilities.** A penalty is a punishment for doing something that is forbidden, and is to be recovered by the state; it can be changed or modified at any time, and it is not enforcible outside of the state; some of the statutory liabilities are similar in form to penalties, but, if they are designed for the protection of creditors in such a way that the offender becomes a debtor to the creditor by his failure, they will be considered contractual in nature, so as to allow suits to be brought in other states for their enforcement in favor of the creditor. If the liability is contractual, subsequent creditors have a vested right in it for their protection, such as cannot be taken away from them without their consent; such a liability also survives and attaches to the

estate of a deceased shareholder, and may be enforced against it, or the representative of a deceased creditor can enforce it against shareholders (84). If a true penalty, such rules do not apply.

§ 231. **Enforcement in other jurisdictions.** If a special remedy is provided in the state creating the statutory liability, of such a nature that the right cannot be separated from its accompanying procedure, and this is different from the procedure in the state where it is sought to be enforced, it will not be there enforced (85); but, if no special remedy is provided, or if it is of a kind that can be enforced in a foreign jurisdiction according to the ordinary procedure there, it will be enforced there. The usual method is through a creditor's bill or receiver, as described above (§ 227) in connection with the common law liability (86). The same rules also apply as to the effect of judgments. The true penal laws of one state, however, are not enforced by the courts of another state (87).

(84) Huntington v. Attrill, 146 U. S. 657.
(85) Marshall v. Sherman, 148 N. Y. 9.
(86) Howarth v. Angle, 162 N. Y. 179.
(87) Wisconsin v. Pelican Ins. Co., 127 U. S. 265.